UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

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

For the quarterly period ended September 30, 2020

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

For the transition period from to

Commission file number 001-36348

PAYLOCITY HOLDING CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**46-4066644** (IRS Employer Identification No.)
1400 American Lane **Schaumburg, Illinois** (Address of principal executive offices)	**60173** (Zip Code)

(847) 463-3200
(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 Stock, par value $0.001 per share	PCTY	The NASDAQ Global Select Market LLC

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.

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 ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 54,245,719 shares of Common Stock, $0.001 par value per share, as of October 30, 2020.

Paylocity Holding Corporation
Form 10-Q
For the Quarterly Period Ended September 30, 2020

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

PAYLOCITY HOLDING CORPORATION
Unaudited Consolidated Balance Sheets
(in thousands, except per share data)

	June 30, 2020	September 30, 2020
Assets		
Current assets:		
Cash and cash equivalents	$ 250,851	$ 221,514
Corporate investments	34,556	18,554
Accounts receivable, net	4,923	4,672
Deferred contract costs	32,332	34,124
Prepaid expenses and other	13,188	15,202
Total current assets before funds held for clients	335,850	294,066
Funds held for clients	1,327,304	1,378,975
Total current assets	1,663,154	1,673,041
Capitalized internal-use software, net	36,501	39,231
Property and equipment, net	66,737	66,068
Operating lease right-of-use assets	48,658	47,080
Intangible assets, net	13,360	12,516
Goodwill	21,655	21,655
Long-term deferred contract costs	125,711	134,328
Long-term prepaid expenses and other	4,917	5,016
Deferred income tax assets	4,955	5,916
Total assets	$ 1,985,648	$ 2,004,851
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,755	$ 3,209
Accrued expenses	79,881	62,343
Total current liabilities before client fund obligations	81,636	65,552
Client fund obligations	1,327,304	1,378,975
Total current liabilities	1,408,940	1,444,527
Long-term debt	100,000	100,000
Long-term operating lease liabilities	73,299	71,460
Other long-term liabilities	1,747	1,676
Deferred income tax liabilities	8,754	368
Total liabilities	$ 1,592,740	$ 1,618,031
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 authorized, no shares issued and outstanding at June 30, 2020 and September 30, 2020	$ —	$ —
Common stock, $0.001 par value, 155,000 shares authorized at June 30, 2020 and September 30, 2020; 53,792 shares issued and outstanding at June 30, 2020 and 54,223 shares issued and outstanding at September 30, 2020	54	54
Additional paid-in capital	227,907	209,582
Retained earnings	164,272	176,732
Accumulated other comprehensive income	675	452
Total stockholders' equity	$ 392,908	$ 386,820
Total liabilities and stockholders' equity	$ 1,985,648	$ 2,004,851

See accompanying notes to unaudited consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Unaudited Consolidated Statements of Operations and Comprehensive Income
(in thousands, except per share data)

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
Revenues:		
Recurring and other revenue	$ 121,873	$ 134,875
Interest income on funds held for clients	4,847	919
Total revenues	126,720	135,794
Cost of revenues	42,630	49,380
Gross profit	84,090	86,414
Operating expenses:		
Sales and marketing	36,957	37,674
Research and development	14,394	18,647
General and administrative	26,739	26,644
Total operating expenses	78,090	82,965
Operating income	6,000	3,449
Other income (expense)	474	(257)
Income before income taxes	6,474	3,192
Income tax benefit	(7,432)	(9,268)
Net income	$ 13,906	$ 12,460
Other comprehensive income (loss), net of tax		
Unrealized gains (losses) on securities, net of tax	4	(223)
Total other comprehensive income (loss), net of tax	4	(223)
Comprehensive income	$ 13,910	$ 12,237
Net income per share:		
Basic	$ 0.26	$ 0.23
Diluted	$ 0.25	$ 0.22
Weighted-average shares used in computing net income per share:		
Basic	53,287	54,015
Diluted	55,713	56,050

See accompanying notes to unaudited consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Unaudited Consolidated Statement of Changes in Stockholders' Equity
(in thousands)

	Three Months Ended September 30, 2019						
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balances at June 30, 2019	53,075	$ 53	$ 207,982	$ 99,817	$ 112	$ 307,964
Stock-based compensation	—	—	12,718	—	—	12,718
Stock options exercised	8	—	120	—	—	120
Issuance of common stock upon vesting of restricted stock units	677	1	(1)	—	—	—
Net settlement for taxes and/or exercise price related to equity awards	(249)	—	(25,253)	—	—	(25,253)
Unrealized gains on securities, net of tax	—	—	—	—	4	4
Net income	—	—	—	13,906	—	13,906
Balances at September 30, 2019	53,511	$ 54	$ 195,566	$ 113,723	$ 116	$ 309,459

	Three Months Ended September 30, 2020					
	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount				
Balances at June 30, 2020	53,792	$ 54	$ 227,907	$ 164,272	$ 675	$ 392,908
Stock-based compensation	—	—	15,046	—	—	15,046
Stock options exercised	88	—	529	—	—	529
Issuance of common stock upon vesting of restricted stock units	599	—	—	—	—	—
Net settlement for taxes and/or exercise price related to equity awards	(256)	—	(33,900)	—	—	(33,900)
Unrealized losses on securities, net of tax	—	—	—	—	(223)	(223)
Net income	—	—	—	12,460	—	12,460
Balances at September 30, 2020	54,223	$ 54	$ 209,582	$ 176,732	$ 452	$ 386,820

See accompanying notes to the unaudited consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Unaudited Consolidated Statements of Cash Flows
(in thousands)

	Three Months Ended September 30, 2019	2020
Cash flows from operating activities:		
Net income	$ 13,906	$ 12,460
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Stock-based compensation expense	12,062	14,277
Depreciation and amortization expense	8,933	10,235
Deferred income tax benefit	(7,431)	(9,268)
Provision for credit losses	—	56
Net accretion of discounts and amortization of premiums on available-for-sale securities	(485)	133
Amortization of debt issuance costs	33	37
Loss on disposal of equipment	85	31
Changes in operating assets and liabilities:		
Accounts receivable	452	195
Deferred contract costs	(9,987)	(10,409)
Prepaid expenses and other	(89)	(2,144)
Accounts payable	39	1,611
Accrued expenses and other	(9,253)	(18,781)
Net cash provided by (used in) operating activities	8,265	(1,567)
Cash flows from investing activities:		
Purchases of available-for-sale securities and other	(63,621)	—
Proceeds from sales and maturities of available-for-sale securities	45,154	37,493
Capitalized internal-use software costs	(6,714)	(7,884)
Purchases of property and equipment	(8,033)	(2,045)
Net cash provided by (used in) investing activities	(33,214)	27,564
Cash flows from financing activities:		
Net change in client fund obligations	(239,942)	51,671
Taxes paid related to net share settlement of equity awards	(24,749)	(33,402)
Payment of debt issuance costs	(669)	(9)
Net cash provided by (used in) financing activities	(265,360)	18,260
Net change in cash, cash equivalents and funds held for clients' cash and cash equivalents	(290,309)	44,257
Cash, cash equivalents and funds held for clients' cash and cash equivalents—beginning of period	1,426,143	1,492,133
Cash, cash equivalents and funds held for clients' cash and cash equivalents—end of period	$ 1,135,834	$ 1,536,390
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Purchases of property and equipment, accrued but not paid	$ 1,249	$ 1,479
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest	$ —	$ 311
Cash paid (refunds received) for income taxes	$ 11	$ (119)
Reconciliation of cash, cash equivalents and funds held for clients' cash and cash equivalents to the Consolidated Balance Sheets		
Cash and cash equivalents	$ 100,529	$ 221,514
Funds held for clients' cash and cash equivalents	1,035,305	1,314,876
Total cash, cash equivalents and funds held for clients' cash and cash equivalents	$ 1,135,834	$ 1,536,390

See accompanying notes to unaudited consolidated financial statements.

PAYLOCITY HOLDING CORPORATION
Notes to the Unaudited Consolidated Financial Statements
(all amounts in thousands, except per share data)

(1) Organization and Description of Business

Paylocity Holding Corporation (the "Company") is a cloud-based provider of payroll and human capital management software solutions for medium-sized organizations. Services are provided in a Software-as-a-Service ("SaaS") delivery model utilizing the Company's cloud-based platform. The Company's comprehensive product suite delivers a unified platform that allows clients to make strategic decisions in the areas of payroll, core HR, workforce management, talent and benefits.

(2) Summary of Significant Accounting Policies

(a) ***Basis of Presentation, Consolidation and Use of Estimates***

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

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future events, including the impact from the outbreak of the novel coronavirus disease ("COVID-19"), and their effects cannot be predicted with certainty; accordingly, accounting estimates require the exercise of judgment. Accounting estimates used in the preparation of these consolidated financial statements may change as new events occur, more experience and additional information is acquired, and the operating environment evolves, including the ongoing impact of COVID-19.

(b) ***Interim Unaudited Consolidated Financial Information***

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with GAAP and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the Company's financial position, results of operations, changes in stockholders' equity and cash flows. The results of operations for the three months ended September 30, 2020 are not necessarily indicative of the results for the full year or the results for any future periods. The impact of the COVID-19 pandemic will not be fully known or reflected in the Company's results of operations and overall financial performance until future periods. Refer to "Part I. Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K filed with the SEC on August 7, 2020 for risks related to the COVID-19 pandemic and its impact on the Company's business and financial performance. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the year ended June 30, 2020 included in the Company's Annual Report on Form 10-K.

(c) ***Income Taxes***

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

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

(d) ***Recently Adopted Accounting Standards***

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which requires the measurement and recognition of expected credit losses for financial instruments held at amortized cost, including trade receivables. Under ASU 2016-13, the Company assesses its allowance for credit losses on accounts receivable by taking into consideration current economic conditions, reasonable and supportable forecasts, as well as past experience including historical write-off trends and client-specific circumstances. The new standard also eliminated the concept of other-than-temporary impairment and requires expected credit losses related to available-for-sale debt securities to be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The Company adopted this standard effective July 1, 2020, using a modified retrospective approach, and the adoption did not have a material impact on the Company's financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement ("ASU 2018-13"), which amends the requirements for fair value measurement disclosures. ASU 2018-13 removes, modifies or adds certain disclosure requirements under GAAP. The Company adopted this standard on July 1, 2020, and removed or modified disclosure requirements retrospectively to all periods presented, whereas any new requirements are being applied prospectively from the adoption date. The adoption of this standard did not have a material impact on the Company's financial statements.

In December 2019, the FASB issued ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes ("ASU 2019-12") which provides guidance to reduce complexity in certain areas of accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and simplifies various aspects of the current guidance to promote consistent application of the standard among reporting entities. The Company adopted ASU 2019-12 on July 1, 2020, and the adoption of this standard did not have a material impact on the Company's financial statements.

(e) ***Recently Issued Accounting Standards***

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

(3) Revenue

The Company derives its revenue from contracts predominantly from recurring and non-recurring service fees. While the majority of its agreements are generally cancellable by the client on 60 days' notice or less, the Company also has term arrangements, which are generally two years in length. Recurring fees are derived from payroll, timekeeping, and HR-related cloud-based computing services. The majority of the Company's recurring fees are satisfied over time as services are provided. The performance obligations related to payroll services are satisfied upon the processing of the client's payroll with the fee charged and collected based on a per employee per payroll frequency fee. The performance obligations related to time and attendance services and HR related services are satisfied over time each month with the fee charged and collected based on a per employee per month fee. For subscription-based fees which can include payroll, time and attendance, and HR related services, the Company recognizes the applicable recurring fees over time each month with the fee charged and collected based on a per employee per month fee. Non-recurring service fees consist mainly of nonrefundable implementation fees, which involve setting the client up in, and loading data into, the

Company's cloud-based modules. These implementation activities are considered set-up activities. The Company has determined that the nonrefundable upfront fees provide certain clients with a material right to renew the contract. Implementation fees are deferred and amortized generally over a period up to 24 months.

Disaggregation of revenue

The following table disaggregates revenue by Recurring fees and Implementation services and other, which the Company believes depicts the nature, amount and timing of its revenue:

	Three Months Ended September 30,	
	2019	2020
Recurring fees	$ 117,777	$ 129,692
Implementation services and other	4,096	5,183
Total revenues from contracts	$ 121,873	$ 134,875

Deferred revenue

The timing of revenue recognition for recurring revenue is consistent with the timing of invoicing as they occur simultaneously based on the client's payroll frequency or by month for subscription-based fees. As such, the Company does not recognize contract assets or liabilities related to recurring revenue.

The nonrefundable upfront fees related to implementation services are invoiced with the client's first payroll period. The Company defers and amortizes these nonrefundable upfront fees generally over a period up to 24 months based on the type of contract. The following table summarizes the changes in deferred revenue (i.e. contract liability) related to these nonrefundable upfront fees as follows:

	Three Months Ended September 30,	
	2019	2020
Balance at beginning of the period	$ 6,289	$ 8,434
Deferral of revenue	3,071	3,130
Revenue recognized	(2,780)	(3,894)
Balance at end of the period	$ 6,580	$ 7,670

Deferred revenue related to these nonrefundable upfront fees are recorded within Accrued expenses and Other long-term liabilities on the Unaudited Consolidated Balance Sheets. The Company expects to recognize these deferred revenue balances of $5,320 in fiscal 2021, $2,116 in fiscal 2022 and $234 in fiscal 2023 and thereafter.

Deferred contract costs

The Company defers certain selling and commission costs that meet the capitalization criteria under ASC 340-40. The Company also capitalizes certain costs to fulfill a contract related to its proprietary products if they are identifiable, generate or enhance resources used to satisfy future performance obligations and are expected to be recovered under ASC 340-40. Implementation fees are treated as nonrefundable upfront fees and the related implementation costs are required to be capitalized and amortized over the expected period of benefit, which is the period in which the Company expects to recover the costs and enhance its ability to satisfy future performance obligations.

The Company utilizes the portfolio approach to account for both the cost of obtaining a contract and the cost of fulfilling a contract. These capitalized costs are amortized over the expected period of benefit, which has been determined to be over 7 years based on the Company's average client life and other qualitative factors, including rate of technological changes. The Company does not incur any additional costs to obtain or fulfill contracts upon renewal. The Company recognizes additional selling and commission costs and fulfillment costs when an existing client purchases additional services. These additional costs only relate to the additional services purchased and do not relate to the renewal of previous services.

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

	Three Months Ended September 30, 2019			
	Beginning Balance	Capitalized Costs	Amortization	Ending Balance
Costs to obtain a new contract	$ 82,103	$ 9,486	$ (4,901)	$ 86,688
Costs to fulfill a contract	20,996	6,366	(964)	26,398
Total	$ 103,099	$ 15,852	$ (5,865)	$ 113,086

	Three Months Ended September 30, 2020			
	Beginning Balance	Capitalized Costs	Amortization	Ending Balance
Costs to obtain a new contract	$ 113,575	$ 11,641	$ (6,572)	$ 118,644
Costs to fulfill a contract	44,468	7,361	(2,021)	49,808
Total	$ 158,043	$ 19,002	$ (8,593)	$ 168,452

Deferred contract costs are recorded within Deferred contract costs and Long-term deferred contract costs on the Unaudited Consolidated Balance Sheets. Amortization of deferred contract costs is recorded in Cost of revenues, Sales and marketing, and General and administrative in the Unaudited Consolidated Statements of Operations and Comprehensive Income.

Remaining Performance Obligations

The balance of the Company's remaining performance obligations related to minimum monthly fees on its term-based contracts was approximately $45,647 as of September 30, 2020, which will be generally recognized over the next 24 months. This balance excludes the value of unsatisfied performance obligations for contracts that have an original expected duration of one year or less and contracts for which the variable consideration is allocated entirely to wholly unsatisfied performance obligations.

(4) Balance Sheet Information

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

Activity in the allowance for credit losses related to accounts receivable was as follows:

Balance at June 30, 2020	617
Charged to expense	56
Write-offs	(22)
Balance at September 30, 2020	$ 651

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

	June 30, 2020	September 30, 2020
Capitalized internal-use software	$ 119,178	$ 127,294
Accumulated amortization	(82,677)	(88,063)
Capitalized internal-use software, net	$ 36,501	$ 39,231

Amortization of capitalized internal-use software costs is included in Cost of revenues and amounted to $4,457 and $5,386 for the three months ended September 30, 2019 and 2020, respectively.

Property and equipment, net consist of the following:

	June 30, 2020	September 30, 2020
Office equipment	$ 4,619	$ 4,843
Computer equipment	42,936	44,885
Furniture and fixtures	12,723	13,151
Software	6,609	6,585
Leasehold improvements	46,192	46,615
Time clocks rented by clients	4,967	4,927
Total	118,046	121,006
Accumulated depreciation	(51,309)	(54,938)
Property and equipment, net	$ 66,737	$ 66,068

Depreciation expense amounted to $3,913 and $4,005 for the three months ended September 30, 2019 and 2020, respectively.

In April 2020, the Company acquired all of the shares outstanding of VidGrid, Inc. (“VidGrid”). During the three months ended September 30, 2020, the Company completed its purchase accounting for this acquisition and did not record any changes to the preliminary purchase price allocation. Accordingly, goodwill did not change during the three months ended September 30, 2020. Refer to Note 6 of the audited consolidated financial statements included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2020 for additional details on the acquisition of VidGrid.

The Company’s amortizable intangible assets and estimated useful lives are as follows:

	June 30, 2020	September 30, 2020	Useful Life
Client relationships	$ 19,200	$ 19,200	5 - 9 years
Proprietary technology	2,962	2,962	5 years
Non-solicitation agreements	1,350	1,350	2 - 4 years
Trade name	350	350	5 years
Total	23,862	23,862	
Accumulated amortization	(10,502)	(11,346)	
Intangible assets, net	$ 13,360	$ 12,516	

Amortization expense for acquired intangible assets was $563 and $844 for the three months ended September 30, 2019 and 2020, respectively.

Future amortization expense for acquired intangible assets as of September 30, 2020 is as follows:

Remainder of fiscal 2021	$ 2,533
Fiscal 2022	3,358
Fiscal 2023	3,185
Fiscal 2024	2,232
Fiscal 2025	1,208
Total	$ 12,516

The components of accrued expenses were as follows:

	June 30, 2020	September 30, 2020
Accrued payroll and personnel costs	$ 53,284	$ 35,444
Operating lease liabilities	8,083	7,977
Deferred revenue	8,777	8,784
Other	9,737	10,138
Total accrued expenses	$ 79,881	$ 62,343

(5) Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients consist of the following:

	June 30, 2020			
Type of Issue	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	$ 250,851	$ —	$ —	$ 250,851
Funds held for clients' cash and cash equivalents	1,241,282	—	—	1,241,282
Available-for-sale securities:				
Commercial paper	6,643	6	—	6,649
Corporate bonds	44,343	414	—	44,757
Asset-backed securities	49,978	424	—	50,402
U.S. treasury securities	21,302	67	—	21,369
Total available-for-sale securities (1)	122,266	911	—	123,177
Total investments	$ 1,614,399	$ 911	$ —	$ 1,615,310

(1) Included within the fair value of total available-for-sale securities above is $37,155 of corporate investments and $86,022 of funds held for clients.

	September 30, 2020			
Type of Issue	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	$ 221,514	$ —	$ —	$ 221,514
Funds held for clients' cash and cash equivalents	1,314,876	—	—	1,314,876
Available-for-sale securities:				
Corporate bonds	42,270	311	—	42,581
Asset-backed securities	38,220	292	—	38,512
U.S. treasury securities	4,150	5	—	4,155
Total available-for-sale securities (2)	84,640	608	—	85,248
Total investments	$ 1,621,030	$ 608	$ —	$ 1,621,638

(2) Included within the fair value of total available-for-sale securities above is $21,149 of corporate investments and $64,099 of funds held for clients.

Cash and cash equivalents and funds held for clients’ cash and cash equivalents include demand deposit accounts and money market funds at June 30, 2020 and September 30, 2020.

Classification of investments on the unaudited consolidated balance sheets is as follows:

	June 30, 2020	September 30, 2020
Cash and cash equivalents	$ 250,851	$ 221,514
Corporate investments	34,556	18,554
Funds held for clients	1,327,304	1,378,975
Long-term prepaid expenses and other	2,599	2,595
Total investments	$ 1,615,310	$ 1,621,638

There were no available-for-sale securities in an unrealized loss position at June 30, 2020 or September 30, 2020. The Company regularly reviews the composition of its portfolio to determine the existence of credit impairment. The Company did not recognize any credit impairment losses during the three months ended September 30, 2020. All securities in the Company's portfolio held an A-1 rating or better as of September 30, 2020.

The Company did not make any material reclassification adjustments out of accumulated other comprehensive income for realized gains and losses on the sale of available-for-sale securities during the three months ended September 30, 2019 or 2020. Gross realized gains and losses on the sale of available-for-sale securities were immaterial for both the three months ended September 30, 2019 and 2020.

Expected maturities of available-for-sale securities at September 30, 2020 are as follows:

	Amortized cost	Fair value
One year or less	$ 75,701	$ 76,152
One year to two years	8,939	9,096
Total available-for-sale securities	$ 84,640	$ 85,248

(6) Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1—Quoted prices in active markets for identical assets and liabilities.
- Level 2—Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Company measures certain cash and cash equivalents, accounts receivable, accounts payable and client fund obligations at fair value on a recurring basis using Level 1 inputs. The Company considers the recorded value of these financial assets and liabilities to approximate the fair value of the respective assets and liabilities at June 30, 2020 and September 30, 2020 based upon the short-term nature of these assets and liabilities.

Marketable securities, consisting of securities classified as available-for-sale as well as certain cash equivalents, are recorded at fair value on a recurring basis using Level 2 inputs obtained from an independent pricing service. Available-for-sale securities include commercial paper, corporate bonds, asset-backed securities and U.S. treasury securities. The independent pricing service utilizes a variety of inputs including benchmark yields, broker/dealer quoted prices, reported trades, issuer spreads as well as other available market data. The Company, on a sample basis, validates the pricing from the independent pricing service against another third-party pricing source for reasonableness. The

Company has not adjusted any prices obtained by the independent pricing service, as it believes they are appropriately valued. There were no available-for-sale securities classified in Level 3 of the fair value hierarchy at June 30, 2020 or September 30, 2020.

The fair value level for the Company's cash and cash equivalents and available-for-sale securities is as follows:

	June 30, 2020			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 250,851	$ 250,851	$ —	$ —
Funds held for clients' cash and cash equivalents	1,241,282	1,241,282	—	—
Available-for-sale securities:				
Commercial paper	6,649	—	6,649	—
Corporate bonds	44,757	—	44,757	—
Asset-backed securities	50,402	—	50,402	—
U.S. treasury securities	21,369	—	21,369	—
Total available-for-sale securities	123,177	—	123,177	—
Total investments	$ 1,615,310	$ 1,492,133	$ 123,177	$ —

	September 30, 2020			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 221,514	$ 221,514	$ —	$ —
Funds held for clients' cash and cash equivalents	1,314,876	1,314,876	—	—
Available-for-sale securities:				
Corporate bonds	42,581	—	42,581	—
Asset-backed securities	38,512	—	38,512	—
U.S. treasury securities	4,155	—	4,155	—
Total available-for-sale securities	85,248	—	85,248	—
Total investments	$ 1,621,638	$ 1,536,390	$ 85,248	$ —

The Company determined that the carrying value of long-term debt under its revolving credit facility approximates fair value, which is classified as Level 2, because interest rates associated with the borrowings reflect market rates.

(7) Debt

In July 2019, the Company entered into a five-year revolving credit agreement with PNC Bank, National Association, and other lenders, which is secured by substantially all of the Company's assets, subject to certain restrictions. The revolving credit agreement provides for a senior secured revolving credit facility (the "credit facility") under which the Company may borrow up to $250,000, which may be increased to up to $375,000, subject to obtaining additional lender commitments and certain approvals and satisfying other requirements. The credit facility is scheduled to mature in July 2024. As of September 30, 2020, the Company had $100,000 in borrowings outstanding under the credit facility.

The proceeds of any borrowings are to be used to fund working capital, capital expenditures and general corporate purposes, including permitted acquisitions, permitted investments, permitted distributions and share repurchases. The Company may generally borrow, prepay and reborrow under the credit facility and terminate or reduce the lenders' commitments at any time prior to revolving credit facility expiration without a premium or a penalty, other than customary "breakage" costs with respect to London Interbank Offered Rate ("LIBOR") revolving loans.

Any borrowings under the credit facility will generally bear interest, at the Company's option, at a rate per annum determined by reference to either the LIBOR (or a replacement index for the LIBOR rate) or an adjusted base rate, in each case plus an applicable margin ranging from 0.875% to 1.375% and 0.0% to 0.375%, respectively, based on the then-applicable net senior secured leverage ratio. Additionally, the Company is required to pay certain commitment, letter of credit fronting and letter of credit participation fees on available and/or undrawn portions of the credit facility.

Under the credit facility, the Company is required to comply with certain customary affirmative and negative covenants, including a requirement to maintain a maximum net total leverage ratio of not greater than 4.00 to 1.00, a maximum net senior secured leverage ratio of not greater than 3.50 to 1.00 and a minimum interest coverage ratio of not less than 3.00 to 1.00. As of September 30, 2020, the Company was in compliance with all of the aforementioned covenants.

(8) Stock-Based Compensation

The Company maintains a 2008 Equity Incentive Plan (the "2008 Plan") and a 2014 Equity Incentive Plan (the "2014 Plan") pursuant to which the Company has reserved shares of its common stock for issuance to its employees, directors and non-employee third parties. The 2014 Plan serves as the successor to the 2008 Plan and permits the granting of restricted stock units and other equity incentives at the discretion of the compensation committee of the Company's board of directors. No new awards have been or will be issued under the 2008 Plan since the effective date of the 2014 Plan. Outstanding awards under the 2008 Plan continue to be subject to the terms and conditions of the 2008 Plan. The number of shares of common stock reserved for issuance under the 2014 Plan may increase each calendar year, continuing through and including January 1, 2024. The number of shares added each year may be equal to the lesser of (a) four and five tenths percent (4.5%) of the number of shares of common stock of the Company issued and outstanding on the immediately preceding December 31, or (b) an amount determined by the Company's board of directors.

As of September 30, 2020, the Company had 11,931 shares allocated to the plans, of which 2,673 shares were subject to outstanding options or awards. Generally, the Company issues previously unissued shares for the exercise of stock options or vesting of awards; however, shares previously subject to 2014 Plan grants or awards that are forfeited or net settled at exercise or release may be reissued to satisfy future issuances.

The following table summarizes changes in the number of shares available for grant under the Company's equity incentive plans during the three months ended September 30, 2020:

	Number of Shares
Available for grant at July 1, 2020	9,519
RSUs granted	(465)
MSUs granted	(58)
Shares withheld in settlement of taxes and/or exercise price	256
Forfeitures	44
Shares removed	(38)
Available for grant at September 30, 2020	9,258

Shares removed represents forfeitures of shares and shares withheld in settlement of taxes and/or payment of exercise price related to grants made under the 2008 Plan. As noted above, no new awards will be issued under the 2008 Plan.

Stock-based compensation expense related to stock options, restricted stock units ("RSUs"), market share units ("MSUs") and the Employee Stock Purchase Plan is included in the following line items in the accompanying unaudited consolidated statements of operations and comprehensive income:

	Three Months Ended September 30,	
	2019	2020
Cost of revenues	$ 1,249	$ 1,832
Sales and marketing	3,968	3,880
Research and development	1,278	2,230
General and administrative	5,567	6,335
Total stock-based compensation expense	$ 12,062	$ 14,277

In addition, the Company capitalized $656 and $769 of stock-based compensation expense in its capitalized internal-use software costs in the three months ended September 30, 2019 and 2020, respectively.

In August 2020, the Company's board of directors approved the Company's fiscal 2021 annual operating plan to reflect the operating and financial impacts of the COVID-19 pandemic. In connection and alignment with the board's approval of the updated operating plan, the compensation committee of the Company's board of directors approved the modification of the performance targets for vesting of the performance-based restricted stock units granted in fiscal 2020. As a result of the modification, the Company recorded $860 in stock-based compensation expense during the three months ended September 30, 2020.

There were no stock options granted during the three months ended September 30, 2019 or 2020. The table below presents stock option activity during the three months ended September 30, 2020:

	Outstanding Options			
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Balance at July 1, 2020	1,255	$ 12.43	2.96	$ 167,406
Options exercised	(88)	$ 6.01		
Balance at September 30, 2020	1,167	$ 12.91	2.76	$ 173,184
Options vested and exercisable at September 30, 2020	1,167	$ 12.91	2.76	$ 173,184

The total intrinsic value of options exercised was $671 and $11,408 during the three months ended September 30, 2019 and 2020, respectively.

The Company grants RSUs under the 2014 Plan with terms determined at the discretion of the compensation committee of the Company's board of directors. RSUs generally vest over three or four years following the grant date. Certain RSU awards have time-based vesting conditions while other RSUs vest based on the achievement of certain revenue growth and Adjusted EBITDA margin targets in future fiscal years. For these performance-based RSUs, the Company recognizes stock-based compensation expense based upon the probable achievement of these aforementioned performance metrics.

The following table represents restricted stock unit activity during the three months ended September 30, 2020:

	Units	Weighted average grant date fair value
RSU balance at July 1, 2020	1,626	$ 73.96
RSUs granted	465	$ 131.81
RSUs vested	(599)	$ 64.40
RSUs forfeited	(44)	$ 75.94
RSU balance at September 30, 2020	1,448	$ 98.81
RSUs expected to vest at September 30, 2020	1,345	$ 98.85

At September 30, 2020, there was $92,872 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested restricted stock units granted. That cost is expected to be recognized over a weighted average period of 2.11 years.

The Company also grants MSUs under the 2014 Plan with terms determined at the discretion of the Committee. In August 2020, the Company granted approximately 58 MSUs with a grant date fair value of $178.04. The actual number of MSUs that will be eligible to vest is based on the achievement of a relative total shareholder return ("TSR") target as compared to the TSR realized by each of the companies comprising the Russell 3000 Index over an approximately three-year period. The MSUs cliff-vest at the end of the TSR measurement period, and up to 200% of the target number of shares subject to each MSU are eligible to be earned.

The Company estimated the grant date fair value of the MSUs using a Monte Carlo simulation model that included the following assumptions for the three months ended September 30, 2020:

Expected dividend yield	0 %
Expected volatility	52.0 %
Expected term (years)	3.04
Risk-free interest rate	0.18 %

At September 30, 2020, there was $8,541 of total unrecognized compensation cost, net of estimated forfeitures, related to unvested MSUs. That cost is expected to be recognized over a period of 2.92 years.

(9) Income Taxes

On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") into law. While the Company continues to analyze the relevant provisions of the CARES Act, it does not expect the provisions of the legislation to have a significant impact on the Company's income taxes.

The Company's quarterly provision for income taxes is based on the annual effective rate method. The Company's quarterly provision for income taxes also includes the tax impact of certain unusual or infrequently occurring items, if any, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, and other discrete items in the interim period in which they occur.

The Company's effective tax rate was (114.8)% and (290.3)% for the three months ended September 30, 2019 and 2020, respectively. The Company's effective tax rate for the three months ended September 30, 2019 and September 30, 2020 was lower than the federal statutory rate of 21% primarily due to excess tax benefits from employee stock-based compensation.

(10) Net Income Per Share

Basic net income per common share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common shares outstanding during the period and, if dilutive, potential common shares outstanding during the period. The Company's potential common shares consist of the incremental common shares issuable upon the exercise of stock options, the release of restricted stock units and market share units, and the shares purchasable via the employee stock purchase plan as of the balance sheet date. The following table presents the calculation of basic and diluted net income per share:

	Three Months Ended September 30,	
	2019	2020
Numerator:		
Net income	$ 13,906	$ 12,460
Denominator:		
Weighted-average shares used in computing net income per share:		
Basic	53,287	54,015
Weighted-average effect of potentially dilutive shares:		
Employee stock options, restricted stock units and employee stock purchase plan shares	2,426	2,035
Diluted	55,713	56,050
Net income per share:		
Basic	$ 0.26	$ 0.23
Diluted	$ 0.25	$ 0.22

The following table summarizes the outstanding restricted stock units and market share units as of September 30, 2020 that were excluded from the diluted per share calculation for the periods presented because to include them would have been anti-dilutive:

	Three Months Ended September 30,	
	2019	2020
Restricted stock units	624	462
Market share units	—	58
Total	624	520

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The statements included herein that are not based solely on historical facts are "forward looking statements." Such forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties. Our actual results could differ materially from those anticipated by us in these forward-looking statements as a result of various factors, including those discussed below and under "Part II, Item 1A. Risk Factors."

Overview

We are a cloud-based provider of payroll and human capital management ("HCM") software solutions for medium-sized organizations, which we define as those having between 10 and 1,000 employees. Our comprehensive and easy-to-use solutions enable our clients to manage their workforces more effectively. Our product suite delivers a unified platform for professionals to make strategic decisions in the areas of payroll, core HR, workforce management, talent and benefits, all while promoting a modern workplace and improving employee engagement.

Effective management of human capital is a core function in all organizations and requires a significant commitment of resources. Our solutions were specifically designed to meet the payroll and HCM needs of medium-sized organizations. We designed our cloud-based platform to provide a unified suite of modules using a multi-tenant architecture. Our solutions are highly flexible and configurable and feature a modern, intuitive user experience. Our platform offers automated data integration with over 400 related third-party systems, such as 401(k), benefits and insurance provider systems.

Our payroll solution was the first of our current offerings introduced into the market. We believe payroll is the most critical system of record for medium-sized organizations and an essential gateway to other HCM functionalities. We have invested in, and we intend to continue to invest in, research and development to expand our product offerings and advance our platform.

We believe there is a significant opportunity to grow our business by increasing our number of clients and we intend to invest in our business to achieve this purpose. We market and sell our solutions through our direct sales force. We have increased our sales and marketing expenses as we have added sales representatives and related sales and marketing personnel. We intend to continue to grow our sales and marketing organization across new and existing geographic territories. In addition to growing our number of clients, we intend to grow our revenue over the long term by increasing the number and quality of products that clients purchase from us. To do so, we must continue to enhance and grow the number of solutions we offer to advance our platform.

We believe that delivering a positive service experience is an essential element of our ability to sell our solutions and retain our clients. We seek to develop deep relationships with our clients through our unified service model, which has been designed to meet the service needs of mid-market organizations. We expect to continue to invest in and grow our implementation and client service organization as our client base grows.

We believe we have the opportunity to continue to grow our business over the long term, and to do so we have invested, and intend to continue to invest, across our entire organization. These investments include increasing the number of personnel across all functional areas, along with improving our solutions and infrastructure to support our growth. The timing and amount of these investments vary based on the rate at which we add new clients, add new personnel and scale our application development and other activities. Many of these investments will occur in advance of experiencing any direct benefit from them, which will make it difficult to determine if we are effectively allocating our resources. We expect these investments to increase our costs on an absolute basis, but as we grow our number of clients and our related revenues, we anticipate that we will gain economies of scale and increased operating leverage. As a result, we expect our gross and operating margins will improve over the long term.

Paylocity Holding Corporation is a Delaware corporation, which was formed in November 2013. Our business operations, excluding interest earned on certain cash holdings and expenses associated with certain secondary stock offerings, have historically been, and are currently, conducted by its wholly owned subsidiaries, and the financial results presented herein are entirely attributable to the results of its operations.

COVID-19 Impact

The novel coronavirus disease ("COVID-19") continues to impact the global economy. The duration and severity of the COVID-19 pandemic, and the long-term effects the pandemic will have on our clients and general economic conditions, remain uncertain and difficult to predict. Many of our prospective and existing clients' businesses have been impacted by stay-at-home, business closure and other restrictive orders, which has resulted in reduced employee headcount, temporary and permanent business closures, and/or delayed sales/starts. Our business and financial performance may continue to be unfavorably impacted in future periods if a significant number of our clients are unable to continue as viable businesses or reduce headcount, there is a reduction in business confidence and activity, a decrease in government and consumer spending, a decrease in payroll and HCM solutions spending by medium-sized organizations, a decrease in growth in the overall market or a further decline of interest rates, among other factors. Therefore, we expect COVID-19 to continue to have an unfavorable impact on the growth in both Recurring and other revenue and Interest income on funds held for clients in future periods for so long as such conditions persist. Refer to "Part I. Item 1A. Risk Factors" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on August 7, 2020 for risks related to the COVID-19 pandemic and its impact on our business and financial performance.

Key Metrics

We regularly review a number of metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

Revenue Growth

Our recurring revenue model and high annual revenue retention rates provide significant visibility into our future operating results and cash flow from operations. This visibility enables us to better manage and invest in our business. Total revenues increased from $126.7 million for the three months ended September 30, 2019 to $135.8 million for the three months ended September 30, 2020, representing a 7% year-over-year increase. Our total revenue growth during the three months ended September 30, 2020 was impacted by the ongoing effects from the COVID-19 pandemic. We expect COVID-19 to continue to unfavorably impact our revenue growth rates in future periods as we anticipate lower client employee counts, potential increases in client losses, a continued low interest rate environment and a decrease in the growth of the overall market, among other factors.

Adjusted Gross Profit and Adjusted EBITDA

We disclose Adjusted Gross Profit and Adjusted EBITDA because we use them to evaluate our performance, and we believe Adjusted Gross Profit and Adjusted EBITDA assist in the comparison of our performance across reporting periods by excluding certain items that we do not believe are indicative of our core operating performance. We believe these metrics are used in the financial community, and we present them to enhance investors' understanding of our operating performance and cash flows.

Adjusted Gross Profit and Adjusted EBITDA are not measurements of financial performance under generally accepted accounting principles in the United States ("GAAP"), and you should not consider Adjusted Gross Profit as an alternative to gross profit or Adjusted EBITDA as an alternative to net income or cash provided by operating activities, in each case as determined in accordance with GAAP. In addition, our definition of Adjusted Gross Profit and Adjusted EBITDA may be different than the definition utilized for similarly-titled measures used by other companies.

We define Adjusted Gross Profit as gross profit before amortization of capitalized internal-use software costs, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises. We define Adjusted EBITDA as net income before interest expense, income tax expense, depreciation and amortization expense, stock-based compensation expense and employer payroll taxes related to stock releases and option exercises and other items as defined below. The table below sets forth our Adjusted Gross Profit and Adjusted EBITDA for the periods presented.

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
	(in thousands)	
Adjusted Gross Profit	$ 90,279	$ 94,203
Adjusted EBITDA	$ 30,477	$ 30,864

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
	(in thousands)	
Reconciliation from Gross Profit to Adjusted Gross Profit		
Gross profit	$ 84,090	$ 86,414
Amortization of capitalized internal-use software costs	4,457	5,386
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	1,732	2,403
Adjusted Gross Profit	$ 90,279	$ 94,203

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
	(in thousands)	
Reconciliation from Net Income to Adjusted EBITDA		
Net income	$ 13,906	$ 12,460
Interest expense	85	340
Income tax expense (benefit)	(7,432)	(9,268)
Depreciation and amortization expense	8,933	10,235
EBITDA	15,492	13,767
Stock-based compensation expense and employer payroll taxes related to stock releases and option exercises	14,029	16,737
Other items*	956	360
Adjusted EBITDA	$ 30,477	$ 30,864

* Represents nonrecurring costs including acquisition-related and lease exit costs.

Basis of Presentation

Revenues

Recurring and other revenue

We derive the majority of our revenues from recurring fees attributable to our cloud-based payroll and HCM software solutions. Recurring fees for each client generally include a base fee in addition to a fee based on the number of client employees and the number of products a client uses. We also charge fees attributable to our preparation of W-2 documents and annual required filings on behalf of our clients. We charge implementation fees for professional services provided to implement our payroll and HCM solutions. Implementations of our payroll solutions typically require only three to four weeks at which point the new client's payroll is first processed using our solution. We implement additional HCM products as requested by clients and leverage the data within our payroll solution to accelerate our implementation processes. Our average client size has continued to be over 100 employees.

We derive revenue from a client based on the solutions purchased by the client, the number of client employees as well as the amount, type and timing of services provided with respect to those client employees. As such, the number of client employees on our system is not a good indicator of our financial results in any period. Recurring and other revenue accounted for 96% and 99% of our total revenues during the three months ended September 30, 2019 and 2020, respectively.

While the majority of our agreements with clients are generally cancellable by the client on 60 days' notice or less, we also have entered into term agreements, which are generally two years in length. Our agreements do not include general rights of return and do not provide clients with the right to take possession of the software supporting the services being provided. We recognize recurring fees in the period in which services are provided and the related performance obligations have been satisfied. We defer implementation fees related to our proprietary products over a period generally up to 24 months.

Interest Income on Funds Held for Clients

We earn interest income on funds held for clients. We collect funds for employee payroll payments and related taxes in advance of remittance to employees and taxing authorities. Prior to remittance to employees and taxing authorities, we earn interest on these funds through demand deposit accounts with financial institutions with which we have automated clearing house, or ACH, arrangements. We also earn interest by investing a portion of funds held for clients in highly liquid, investment-grade marketable securities.

Cost of Revenues

Cost of revenues includes costs to provide our payroll and other HCM solutions which primarily consists of employee-related expenses, including wages, stock-based compensation, bonuses and benefits, relating to the provision of ongoing client support and implementation activities, payroll tax filing, distribution of printed checks and other materials as well as delivery costs, computing costs, and bank fees associated with client fund transfers. Employee costs for recurring support are generally expensed as incurred whereas such costs for implementation of our proprietary products are capitalized and amortized over a period of 7 years. Our cost of revenues is expected to increase in absolute dollars for the foreseeable future as we increase our client base. However, we expect to realize cost efficiencies over the long term as our business scales, resulting in improved operating leverage and increased margins.

We also capitalize a portion of our internal-use software costs, which are then all amortized as Cost of revenues. We amortized $4.5 million and $5.4 million of capitalized internal-use software costs during the three months ended September 30, 2019 and 2020, respectively.

Operating Expenses

Sales and Marketing

Sales and marketing expenses consist primarily of employee-related expenses for our direct sales and marketing staff, including wages, commissions, stock-based compensation, bonuses and benefits, marketing expenses and other related costs. We capitalize certain selling and commission costs related to new contracts or purchases of additional services by our existing clients and amortize them over a period of 7 years. We pay commissions the following month after the start of service or contract signing, and bonuses for attainment of certain annual performance criteria are subsequently paid annually in the first fiscal quarter of the following year.

We will seek to grow our number of clients for the foreseeable future, and therefore our sales and marketing expense is expected to continue to increase in absolute dollars as we grow our sales organization and expand our marketing activities.

Research and Development

Research and development expenses consist primarily of employee-related expenses for our research and development and product management staff, including wages, stock-based compensation, bonuses and benefits. Additional expenses include costs related to the development, maintenance, quality assurance and testing of new technologies and ongoing refinement of our existing solutions. Research and development expenses, other than internal-use software costs qualifying for capitalization, are expensed as incurred.

We capitalize a portion of our development costs related to internal-use software. The timing of our capitalized development projects may affect the amount of development costs expensed in any given period. The table below sets forth the amounts of capitalized and expensed research and development expenses for the three months ended September 30, 2019 and 2020.

	Three Months Ended September 30,	
	2019	2020
	(in thousands)	
Capitalized portion of research and development	$ 6,606	$ 8,116
Expensed portion of research and development	14,394	18,647
Total research and development	$ 21,000	$ 26,763

We expect to grow our research and development efforts as we continue to broaden our product offerings and extend our technological leadership by investing in the development of new technologies and introducing them to new and existing clients. We expect research and development expenses to continue to increase in absolute dollars but to vary as a percentage of total revenue on a period-to-period basis.

General and Administrative

General and administrative expenses consist primarily of employee-related costs, including wages, stock-based compensation, bonuses and benefits for our administrative, finance, accounting, and human resources departments. Additional expenses include consulting and professional fees, occupancy costs, insurance and other corporate expenses. We expect our general and administrative expenses to continue to increase in absolute dollars as our company continues to grow.

Other Income (Expense)

Other income (expense) generally consists of interest income related to interest earned on our cash and cash equivalents and corporate investments, net of losses on disposal of property and equipment and interest expense related to our revolving credit facility.

Results of Operations

The following table sets forth our statements of operations data for each of the periods indicated.

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
	(in thousands)	
Consolidated Statements of Operations Data:		
Revenues:		
Recurring and other revenue	$ 121,873	$ 134,875
Interest income on funds held for clients	4,847	919
Total revenues	126,720	135,794
Cost of revenues	42,630	49,380
Gross profit	84,090	86,414
Operating expenses:		
Sales and marketing	36,957	37,674
Research and development	14,394	18,647
General and administrative	26,739	26,644
Total operating expenses	78,090	82,965
Operating income	6,000	3,449
Other income (expense)	474	(257)
Income before income taxes	6,474	3,192
Income tax benefit	(7,432)	(9,268)
Net income	$ 13,906	$ 12,460

The following table sets forth our statements of operations data as a percentage of total revenues for each of the periods indicated.

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020
Consolidated Statements of Operations Data:		
Revenues:		
Recurring and other revenue	96 %	99 %
Interest income on funds held for clients	4 %	1 %
Total revenues	100 %	100 %
Cost of revenues	34 %	36 %
Gross profit	66 %	64 %
Operating expenses:		
Sales and marketing	29 %	28 %
Research and development	11 %	14 %
General and administrative	21 %	20 %
Total operating expenses	61 %	62 %
Operating income	5 %	2 %
Other income (expense)	0 %	0 %
Income before income taxes	5 %	2 %
Income tax benefit	(6)%	(7)%
Net income	11 %	9 %

Comparison of Three Months Ended September 30, 2019 and 2020

Revenues
($ in thousands)

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020	Change $	Change %
Recurring and other revenue	$ 121,873	$ 134,875	$ 13,002	11 %
Percentage of total revenues	96 %	99 %		
Interest income on funds held for clients	$ 4,847	$ 919	$ (3,928)	(81) %
Percentage of total revenues	4 %	1 %		

Recurring and other revenue

Recurring and other revenue for the three months ended September 30, 2020 increased by $13.0 million, or 11%, to $134.9 million from $121.9 million for three months ended September 30, 2019. Recurring and other revenue increased primarily as a result of incremental revenues from new and existing clients, partially offset by a reduction in client employee counts on our platform due to the ongoing impact from COVID-19.

Interest Income on Funds Held for Clients

Interest income on funds held for clients for the three months ended September 30, 2020 decreased by $3.9 million, or 81% to $0.9 million from $4.8 million for the three months ended September 30, 2019. Interest income on funds held for clients decreased primarily as a result of lower average interest rates due to the interest rate cuts by the Federal Reserve in response to the COVID-19 pandemic. The impact from the reduction in interest rates was partially offset by higher average daily balances for funds held due to the addition of new clients to our client base.

Cost of Revenues
($ in thousands)

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020	Change $	Change %
Cost of revenues	$ 42,630	$ 49,380	$ 6,750	16 %
Percentage of total revenue	34 %	36 %		
Gross margin	66 %	64 %		

Cost of Revenues

Cost of revenues for the three months ended September 30, 2020 increased by $6.8 million, or 16%, to $49.4 million from $42.6 million for the three months ended September 30, 2019. Cost of revenues increased primarily as a result of the continued growth of our business, in particular, $5.3 million in additional employee-related costs resulting from additional personnel necessary to provide services to new and existing clients and $0.9 million in increased internal-use software amortization. Gross margin decreased from 66% for the three months ended September 30, 2019 to 64% for the three months ended September 30, 2020.

Operating Expenses
($ in thousands)

Sales and Marketing

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2020	Change $	Change %
Sales and marketing	$ 36,957	$ 37,674	$ 717	2 %
Percentage of total revenues	29 %	28 %		

Sales and marketing expenses for the three months ended September 30, 2020 increased by $0.7 million, or 2%, to $37.7 million from $37.0 million for the three months ended September 30, 2019. The increase in sales and marketing expense was primarily the result of additional employee-related costs, including those incurred to expand our sales team, partially offset by reduced overall spending on travel and entertainment.

Research and Development

	Three Months Ended September 30,		Change	
	2019	2020	$	%
Research and development	$ 14,394	$ 18,647	$ 4,253	30 %
Percentage of total revenues	11 %	14 %		

Research and development expenses for the three months ended September 30, 2020 increased by $4.3 million, or 30%, to $18.6 million from $14.4 million for the three months ended September 30, 2019. The increase in research and development expenses was primarily the result of $4.3 million of additional employee-related costs related to additional development personnel and $1.0 million in additional stock-based compensation costs associated with our equity incentive plan, partially offset by an additional $1.4 million in capitalized internal-use software costs.

General and Administrative

	Three Months Ended September 30,		Change	
	2019	2020	$	%
General and administrative	$ 26,739	$ 26,644	$ (95)	0 %
Percentage of total revenues	21 %	20 %		

General and administrative expenses for the three months ended September 30, 2020 decreased by $0.1 million, or 0%, to $26.6 million from $26.7 million for the three months ended September 30, 2019. The decrease in general and administrative expense was primarily the result of decreased employee-related costs of $1.4 million, partially offset by the increase in stock-based compensation costs associated with our equity incentive plan of $0.8 million.

Other Income (Expense)

	Three Months Ended September 30,		Change	
	2019	2020	$	%
Other income (expense)	$ 474	$ (257)	$ (731)	(154)%
Percentage of total revenues	0 %	0 %		

Other income (expense) did not materially change for the three months ended September 30, 2020 as compared to the three months ended September 30, 2019.

Income Taxes

Our effective tax rate was (114.8)% and (290.3)% for the three months ended September 30, 2019 and September 30, 2020, respectively. Our effective tax rate for the three months ended September 30, 2019 and September 30, 2020 was lower than the federal statutory rate of 21% primarily due to excess tax benefits from employee stock-based compensation.

Quarterly Trends and Seasonality

Our overall operating results fluctuate from quarter to quarter as a result of a variety of factors, some of which are outside of our control. Our historical results should not be considered a reliable indicator of our future results of operations.

We experience fluctuations in revenues and related costs on a seasonal basis, which are primarily seen in our fiscal third quarter, which ends on March 31 of each year. Specifically, our recurring revenue is positively impacted in our fiscal third quarter as a result of our preparation of W-2 documents for our clients' employees in advance of tax filing requirements. The seasonal fluctuations in revenues also positively impact gross profits during our fiscal third quarter. Our historical results for our fiscal third quarter should not be considered a reliable indicator of our future results of operations. Our interest income earned on funds held for clients is also positively impacted during our fiscal third quarter as a result of our increased collection of funds held for clients. Certain payroll taxes are primarily collected during our fiscal third quarter and subsequently remitted.

Critical Accounting Policies and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses. In accordance with GAAP, we base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Actual results may differ from our estimates under different assumptions or conditions and, to the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

In March 2020, the World Health Organization declared the outbreak of COVID-19 as a pandemic which has caused a global slowdown of economic activity that we believe will continue to unfavorably impact our business operations and financial conditions. The duration and severity of the COVID-19 pandemic, and the effect the pandemic will have on our clients and general economic conditions, remains uncertain and difficult to predict. Accounting estimates used in the preparation of these consolidated financial statements may change as new events occur, more experience and additional information is acquired, and the operating environment evolves including the ongoing impact of COVID-19. Refer to "Part I. Item 1A. Risk Factors" in our Annual Report on Form 10-K filed with the SEC on August 7, 2020 for risks related to the COVID-19 pandemic on its business and financial performance.

Our critical accounting policies and use of estimates are disclosed in our audited consolidated financial statements for the year ended June 30, 2020 included in our Annual Report on Form 10-K.

Liquidity and Capital Resources

Our primary liquidity needs are related to the funding of general business requirements, including working capital requirements, research and development, and capital expenditures. As of September 30, 2020, our principal sources of liquidity were $221.5 million of cash and cash equivalents and $21.1 million of total corporate investments. In July 2019, we entered into and currently maintain a five-year revolving credit agreement. This credit agreement provides for a $250.0 million senior revolving credit facility which may be increased up to $375.0 million. In fiscal 2020, we borrowed $100.0 million under this credit facility, which remained outstanding as of September 30, 2020. Although we currently do not have any anticipated need for this additional liquidity, we utilized the borrowing capacity under our credit agreement in order to provide enhanced financial flexibility due to uncertain market conditions arising from COVID-19. Refer to Note 7 of the Notes to the Unaudited Consolidated Financial Statements for additional detail on the credit agreement.

We invest portions of our excess cash and cash equivalents in highly liquid, investment-grade marketable securities. These investments consist of asset-backed debt securities, corporate debt issuances and U.S. Treasury securities with credit quality ratings of A-1 or higher. As of September 30, 2020, we had not recognized any credit impairment losses related to our investment portfolio.

In order to grow our business, we intend to increase our personnel and related expenses and to make significant investments in our platform, data centers and general infrastructure. The timing and amount of these investments will vary based on our financial condition, the rate at which we add new clients and new personnel and the scale of our module development, data centers and other activities, as well as the extent and duration of COVID-19 on the macro-economic environment. Many of these investments will occur in advance of our experiencing any direct benefit from them, which could negatively impact our liquidity and cash flows during any particular period and may make it difficult to determine if we are effectively allocating our resources. However, we expect to fund our operations, capital expenditures and other investments principally with cash flows from operations, and to the extent that our liquidity needs exceed our cash from operations, we would look to our cash on hand and corporate investments or further utilize the remaining borrowing capacity under our credit facility to satisfy those needs.

Funds held for clients and client fund obligations will vary substantially from period to period as a result of the timing of payroll and tax obligations due. Our payroll processing activities involve the movement of significant funds from accounts of employers to employees and relevant taxing authorities. Though we debit a client's account prior to any disbursement on its behalf, there is a delay between our payment of amounts due to employees and taxing and other regulatory authorities and when the incoming funds from the client to cover these amounts payable actually clear into our operating accounts. We currently have agreements with eleven banks to execute ACH and wire transfers to support our client payroll and tax services. We believe we have sufficient capacity under these ACH arrangements to handle all transaction volumes for the foreseeable future. We primarily collect fees for our services via ACH transactions at the same time we debit the client's account for payroll and tax obligations and thus are able to reduce collectability and accounts receivable risks.

We believe our current cash and cash equivalents, corporate investments, future cash flow from operations, and access to our credit facility will be sufficient to meet our ongoing working capital, capital expenditure and other liquidity requirements for at least the next 12 months, and thereafter, for the foreseeable future.

The following table sets forth data regarding cash flows for the periods indicated:

	Three Months Ended September 30,	
	2019	2020
Net cash provided by (used in) operating activities	$ 8,265	$ (1,567)
Cash flows from investing activities:		
Purchases of available-for-sale securities and other	(63,621)	—
Proceeds from sales and maturities of available-for-sale securities	45,154	37,493
Capitalized internal-use software costs	(6,714)	(7,884)
Purchases of property and equipment	(8,033)	(2,045)
Net cash provided by (used in) investing activities	(33,214)	27,564
Cash flows from financing activities:		
Net change in client fund obligations	(239,942)	51,671
Taxes paid related to net share settlement of equity awards	(24,749)	(33,402)
Payment of debt issuance costs	(669)	(9)
Net cash provided by (used in) financing activities	(265,360)	18,260
Net change in cash, cash equivalents and funds held for clients' cash and cash equivalents	$ (290,309)	$ 44,257

Operating Activities

Net cash provided by (used in) operating activities was $8.3 million and $(1.6) million for the three months ended September 30, 2019 and 2020, respectively. The decrease in net cash provided by (used in) operating activities from the three months ended September 30, 2019 to the three months ended September 30, 2020 was primarily due to net changes in operating assets and liabilities, mostly driven by changes in accrued expenses related to higher payout of sales incentives and prepaid expenses and other during the three months ended September 30, 2020.

Investing Activities

Net cash provided by (used in) investing activities was $(33.2) million and $27.6 million for the three months ended September 30, 2019 and 2020, respectively. The net cash used in investing activities is significantly impacted by the timing of purchases and sales and maturities of investments as we invest portions of excess corporate cash and funds held for clients in highly liquid, investment-grade marketable securities. The amount of funds held for clients invested will vary based on timing of client funds collected and payments due to client employees and taxing and other regulatory authorities.

The change in net cash used in investing activities was primarily due to decreases in purchases of available-for-sale securities of $63.6 million and purchases of property and equipment of $6.0 million, partially offset by the decrease in proceeds from sales and maturities of available-for-sale securities of $7.7 million during the three months ended September 30, 2020 as compared to the three months ended September 30, 2019.

Financing Activities

Net cash provided by (used in) financing activities was $(265.4) million and $18.3 million for the three months ended September 30, 2019 and 2020, respectively. The change in net cash provided by (used in) financing activities was primarily the result of an increase in client fund obligations of $291.6 million due to the timing of client funds collected and related remittance of those funds to client employees and taxing authorities, partially offset by $8.6 million in increased taxes paid related to net share settlement of equity awards during the three months ended September 30, 2020 as compared to the September 30, 202019.

Contractual Obligations and Commitments

Our principal commitments consist of operating lease obligations. The following table summarizes our contractual obligations at September 30, 2020:

	Payment Due By Fiscal Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations*	$ 103,988	$ 1,049	$ 2,099	$ 100,840	$ —
Operating lease obligations	96,825	10,803	18,822	18,561	48,639
Unconditional purchase obligations	10,798	7,639	2,538	611	10
	$ 211,611	$ 19,491	$ 23,459	$ 120,012	$ 48,649

* Represents the contractual maturity of and estimated interest payments on borrowings under our revolving credit facility. Interest was calculated using the interest rate in effect as of September 30, 2020.

Capital Expenditures

We expect to continue to invest in capital spending as we continue to grow our business and expand and enhance our operating facilities, data centers and technical infrastructure. Future capital requirements will depend on many factors, including our rate of sales growth and the ongoing impact from COVID-19. In the event that our sales growth or other factors do not meet our expectations, we may eliminate or curtail capital projects in order to mitigate the impact on our use of cash. Capital expenditures were $8.0 million and $2.0 million for the three months ended September 30, 2019 and 2020, respectively, exclusive of capitalized internal-use software costs of $6.7 million and $7.9 million for the same periods, respectively.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future 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.

New Accounting Pronouncements

Refer to Note 2 of the Notes to the Unaudited Consolidated Financial Statements for a discussion of recently issued accounting standards.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have operations solely in the United States and are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate and certain other exposures as well as risks relating to changes in the general economic conditions in the United States. As discussed in Item 2. Management's Discussion and Analysis of Financial Condition and Results of operations, the novel coronavirus disease ("COVID-19") pandemic has significantly disrupted the global economy and financial markets and we believe it will unfavorably impact our future business and financial performance. Refer to "Part I. Item 1A. Risk Factors" on our Annual Report on Form 10-K filed with the SEC on August 7, 2020 for risks related to the COVID-19 pandemic.

We have not used, nor do we intend to use, derivatives to mitigate the impact of interest rate or other exposure or for trading or speculative purposes.

Interest Rate Risk

As of September 30, 2020, we had cash and cash equivalents of $221.5 million, corporate investments of $21.1 million and funds held for clients of $1,379.0 million. We deposit our cash and cash equivalents and significant portions of our funds held for clients in demand deposit accounts with various financial institutions. We invest portions of our excess cash and cash equivalents and funds held for clients in marketable securities including corporate bonds, asset-backed securities and U.S. treasury securities, which were classified as available-for-sale securities as of September 30, 2020. Our investment policy is focused on generating higher yields from these investments while preserving liquidity and capital. However, as a result of our investing activities, we are exposed to changes in interest rates that may materially affect our financial statements.

In a falling rate environment, a decline in interest rates would decrease our interest income earned on both cash and cash equivalents and funds held for clients. An increase in the overall interest rate environment may cause the market value of our investments in fixed rate available-for-sale securities to decline. If we are forced to sell some or all of these securities at lower market values, we may incur investment losses. However, because we classify all marketable securities as available-for-sale, no gains or losses are recognized due to changes in interest rates until such securities are sold or decreases in fair value are deemed due to expected credit losses. We have not recorded any credit impairment losses on our portfolio to date.

Based upon a sensitivity model that measures market value changes caused by interest rate fluctuations, an immediate 100-basis point change in interest rates would have had an immaterial effect on the market value of our available-for-sale securities as of September 30, 2020. Fluctuations in the value of our available-for-sale securities caused by changes in interest rates are recorded in other comprehensive income and are only realized if we sell the underlying securities.

Additionally, as described in Note 7 of the Notes to the Unaudited Consolidated Financial Statements, we entered into a credit agreement that provides for a revolving credit facility ("credit facility") in the aggregate amount of $250.0 million, which may be increased up to $375.0 million. Borrowings under the credit facility will generally bear interest at a rate based upon the London Interbank Offered Rate ("LIBOR") (or a replacement rate for LIBOR) or, at our sole option, an adjusted base rate plus an applicable margin based on our then-applicable net senior secured leverage ratio. As of September 30, 2020, we had $100.0 million in borrowings outstanding under the credit facility. Because interest rates applicable to the credit facility are variable, we are exposed to market risk from changes in the underlying index rates, which affects our interest expense. A hypothetical increase of 100 basis points in interest rates would not have had a significant impact on our results of operations.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. Nonetheless, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2020, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

Changes in Internal Control over Financial Reporting

We implemented a new financial system during the first quarter of fiscal 2021. The new system allows us to strengthen our ability to scale our business and enhance our internal controls over financial reporting. As part of the financial system implementation, the Company enhanced and modified certain existing internal controls within our general ledger, accounts payable, revenue, and financial reporting functions. We will continue to monitor and ensure effectiveness of any changes in internal controls.

There were no other changes to our internal control over financial reporting during the three-month period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may become involved in litigation related to claims arising from the ordinary course of our business. We believe that there are no claims or actions pending or threatened against us, the ultimate disposition of which would have a material adverse effect on us.

Item 1A. Risk Factors

There have been no material changes in our risk factors disclosed in "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended June 30, 2020 filed with the SEC on August 7, 2020.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

Not applicable.

(b) Use of Proceeds

On March 24, 2014, we completed our initial public offering or IPO, of 8,101,750 shares of common stock, at a price of $17.00 per share, before underwriting discounts and commissions. The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-193661), which was declared effective by the SEC on March 18, 2014. With the proceeds of the IPO, we repaid amounts outstanding under a note issued by us to Commerce Bank & Trust Company on March 9, 2011, which totaled $1.1 million, paid $9.4 million for the purchase of substantially all of the assets of BFKMS Inc. and paid $9.5 million for the purchase of substantially all of the assets of Synergy Payroll, LLC.

On December 17, 2014, we completed a follow-on offering of 4,960,000 shares of common stock at a price of $26.25 per share, before underwriting discounts and commissions. The offer and sale of all of the shares in the follow-on offering were registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-200448) which was declared effective by the SEC on December 11, 2014. There have been no material changes in the planned use of proceeds from the follow-on as described in the final prospectus filed with the SEC pursuant to Rule 424(b) on December 12, 2014.

On September 30, 2015, we completed a secondary offering of 4,301,000 shares of common stock at a price of $29.75 per share, before underwriting discounts and commissions. The offer and sale of all of the shares in the secondary offering were registered under the Securities Act pursuant to a registration statement on Form S-3 (File No. 333-206941) which was declared effective by the SEC on September 25, 2015. The Company did not receive any proceeds from the sale of common stock, as all the shares were sold by shareholders of the Company.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The information required by this Item is set forth in the Index to Exhibits immediately following this page.

INDEX TO EXHIBITS

Exhibit Nos.	Description
3.1	First Amended and Restated Certificate of Incorporation (filed as Exhibit 3.2 of Paylocity Holding Corporation's Form S-1 Registration Statement (Registration No. 333-193661)).
3.2	Amended and Restated Bylaws of Paylocity Holding Corporation (filed as Exhibit 3.2 of Paylocity Holding Corporation's Annual Report on Form 10-K for the year ended June 30, 2017 (File No. 001-36348)).
10.1	Form of Market Stock Units Notice of Grant and Award Agreement under the 2014 Equity Incentive Plan (filed as Exhibit 10.1 of Paylocity Holding Corporation's Current Report on Form 8-K on August 18, 2020 (File No. 001-36348)).
31.1*	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-4 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-4 and 15d-14 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification pursuant to 18 U.S.C. 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer.
32.2**	Certification pursuant to 18 U.S.C. 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Financial Officer.
101.INS*	XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document).
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.
104*	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101).

* Filed herewith
** Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

PAYLOCITY HOLDING CORPORATION

Date:	November 6, 2020	By:	/s/ Steven R. Beauchamp
		Name:	**Steven R. Beauchamp**
		Title:	**Chief Executive Officer (Principal Executive Officer) and Director**
Date:	November 6, 2020	By:	/s/ Toby J. Williams
		Name:	**Toby J. Williams**
		Title:	**Chief Financial Officer (Principal Financial Officer)**

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Steven R. Beauchamp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Paylocity Holding Corporation (the “Company”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s fiscal quarter ended September 30, 2020 that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 6, 2020

/s/ Steven R. Beauchamp

Name: **Steven R. Beauchamp**
Title: **Chief Executive Officer (Principal Executive Officer) and Director**

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302(a) OF THE SARBANES-OXLEY ACT OF 2002

I, Toby J. Williams, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Paylocity Holding Corporation (the “Company”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s fiscal quarter ended September 30, 2020 that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 6, 2020

	/s/ Toby J. Williams
Name:	**Toby J. Williams**
Title:	**Chief Financial Officer (Principal Financial Officer)**

EXHIBIT 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Executive Officer of Paylocity Holding Corporation (the “Company”), does hereby certify under the standards set forth and solely for the purposes of 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of the Company for the period ended September 30, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in that Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 6, 2020

/s/ Steven R. Beauchamp

Steven R. Beauchamp
Chief Executive Officer (Principal Executive Officer) and Director

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Financial Officer of Paylocity Holding Corporation (the "Company"), does hereby certify under the standards set forth and solely for the purposes of 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of the Company for the period ended September 30, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in that Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 6, 2020

/s/ Toby J. Williams

Toby J. Williams
Chief Financial Officer (Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.