THIS RESEARCH REPORT EXPRESSES SOLELY OUR OPINIONS. We are short sellers. We are biased. So are long investors. So is Dayforce. So are the banks that raised money for the Company. If you are invested (either long or short) in Dayforce, so are you. Just because we are biased does not mean that we are wrong. Use BOC Texas, LLC's research opinions at your own risk. This report and its contents are not intended to be and do not constitute or contain any financial product advice. Investors should seek their own financial, legal and tax advice in respect of any decision regarding any securities discussed herein. You should do your own research and due diligence before making any investment decisions, including with respect to the securities discussed herein. We have a short interest in Dayforce's securities and therefore stand to realize significant gains in the event that the price of such securities declines. Please refer to our full disclaimer located on the last page of this report.

COMPANY: Dayforce, Inc. | NYSE: DAY
INDUSTRY: Human Capital Management Software

PRICE (AS OF CLOSE 4/3/2024)
USD 64.55
MARKET CAP
USD 10.1 BN

We are short Dayforce, Inc. ("Dayforce" or the "Company"), an S&P 500 human capital management business which we believe engages in highly aggressive revenue recognition and accounting maneuvers to inappropriately pull forward revenues and inflate profits.

We also believe that Dayforce manipulates key profitability metrics which not only misleads investors but unjustly enriches management, whose compensation is tied to such bogus profitability metrics or directly benefit from the Company's aggressive accounting.

Dayforce is plagued by worst-in-class GAAP gross margins, yet its stock trades at an unjustified 25%+ premium above other human capital management companies, likely because of a latticework of misperceptions created around the Company's business and true profitability. This premium is even more absurd under a proper apples-to-apples comparison when we adjust Dayforce's financials to remove the impact of what we consider to be financial alchemy.

Once we adjust Dayforce's financials to remove the impact of inappropriately pulled forward revenues, accounting gymnastics, and non-industry standard cost exclusions, we estimate that Dayforce trades at an eye-popping 38.8x FY23 adjusted EBITDA and 56.9x FY23 adjusted EBIT. An apples-to-apples comparison to other HCM companies implies a ~50% downside for the stock.

But even this is likely conservative, as Dayforce is a governance mess beset by absurd executive pay packages, misleading non-GAAP metrics, unusual adverse auditor opinions on internal controls, insider selling and heavy management turnover. Ultimately, we believe that Dayforce is set up for an ugly correction as investors come to understand the pedestrian and chronically unprofitable business beneath a façade of financial alchemy.

1. **Inappropriate Revenue Pull Forward Inflates Top Line and Profits**. We believe that Dayforce is engaging in highly aggressive and suspect revenue recognition practices to inappropriately pull forward revenue under its contracts, thereby inflating top line growth and profits. Because customers generally pay in monthly installments over time, Dayforce has discretion, for financial reporting purposes, over how much revenue it can pull forward and recognize for professional service fees towards the beginning of its contract. Inexplicably, Dayforce recognizes far more professional service revenues (16-19% of total revenue ex float) than leading HCM companies Workday and ADP (<10% of total), and vastly more than middle market peers like Paycom and Paylocity (2-4% of total revenue ex. float). Even more suspiciously, Dayforce's proportion of professional service revenues is inexplicably increasing despite a pivot towards outsourcing over 50% of onboarding to third party systems integrators. If Dayforce is increasingly outsourcing professional services to third parties, why is it recognizing more professional service revenues than previous quarters and far more than its peers?

   We think the answer is simply accounting magic. In our opinion, evidence suggests that Dayforce is abusing the highly subjective determination of stand-alone selling prices ("SSPs") for implementation services to pull forward a greater proportion of the value of its contracts. We suspect that this prompted Dayforce's auditor to take the unusual step of **rescinding** its previous opinion on the Company's internal controls and, in a highly unusual mid-year update, issue an **adverse opinion** on Dayforce's internal controls specifically related the allocation of revenues under this framework. If we adjust Dayforce's financials to remove the effect of what we believe to be inappropriately pulled forward revenue, we estimate that **Dayforce's actual operating profits are 78% less than reported**.

2. **Misleading Investors on "Most Important" Profitability Metric**. With GAAP gross margins of ~40%, Dayforce is easily the least profitable of its human capital management (HCM) peers. To distract from this uncomfortable fact, management directs

investors' attention to a made-up non-GAAP figure called **adjusted cloud recurring gross margin**, which the Company characterizes as its "most important metric." Yet compared to its peers, Dayforce's highly aggressive calculation appears to be an outlier, both overcounting revenue and inappropriately excluding recurring costs. First, this bogus metric inexplicably and arbitrarily excludes what appear to be product management expenses associated with recurring revenue. Second, unlike most competitors, Dayforce's claimed profitability metric includes "float revenue," or non-operating investment income with 100% gross margins, heavily inflating its adjusted recurring gross margins. When we compare Dayforce's profitability to its peers on an apples-to-apples basis, its core SaaS business is so pedestrian that we estimate its **recurring gross margin is 57%, rather than the Company's reported 78% non-GAAP figure**.

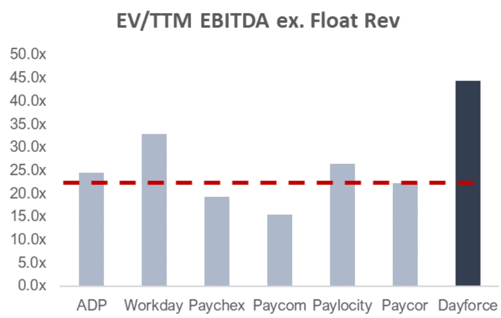
Management has significant incentive to manipulate this critical non-GAAP metric. Frequently the subject of stinging criticism in the media for outrageous pay packages and excessive greed, management recently tied their own compensation packages to these nonsense non-GAAP performance indicators. In 2021, shareholders tried to check such excessive greed by overwhelmingly rejecting management's compensation plan. But just two short years later, when rising interest rates caused float revenue to double, management quietly added float revenue back into the 2023 incentive plan compensation calculation. In short, we believe that, by creating a heavily manipulated set of non-GAAP metrics, management misleads investors about the profitability of the Company. Management then issues itself exorbitant performance rewards tied to these bogus profitability metrics. All the while, Dayforce reports pedestrian results and net losses in four of the past six years.

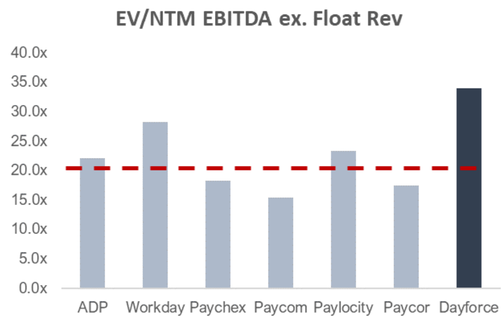
3. **Aggressive Accounting Gimmicks Inflate Earnings and Cash Flows**. Shares of Dayforce rallied after its Q1 2023 earnings call, when the Company announced its first positive profit in eleven quarters. Yet our research suggests that this alleged turnaround was largely a mirage created by aggressive accounting gimmicks which, in our opinion, deceived investors regarding the profitability and cash flows of Dayforce's business. First, Dayforce inappropriately doubled its amortization period for commission costs from five to ten years, even though the typical Dayforce customer contract lasts only three years. By doubling the amortization period for sales commissions to ten years, we estimate that this accounting gimmick alone inflated Dayforce's reported pre-tax operating profit by 60%, without any fundamental improvement to the underlying business. Moreover, Dayforce capitalized an incredible 44% of the Company's software development costs while competitors capitalized only a median of 29%. Our calculations suggest that **these aggressive accounting maneuvers allow Dayforce to artificially inflate its pre-tax profit by 96%**, further obscuring the Company's true profitability from investors.

4. **Half a Billion Dollar Error, Adverse Auditor Opinions, Insider Sales and Executive Turnover**. For an S&P 500 company, Dayforce appears to be a governance mess. In November 2023, the Company inexplicably disclosed that **it forgot to report a over half a billion dollars of customer funds**. Dayforce dismissed the mistake as immaterial, but we question how an S&P 500 constituent could have undercounted half a billion dollars of customer funds? As a result, Dayforce disclosed a warning of material weaknesses in its internal controls. This is highly unusual: financial data provider Hudson Labs states that less than 4% of large cap companies have reported material weaknesses in internal controls. Compounding its governance troubles, Dayforce insiders have been leaving the Company at an alarming rate. In 2023 alone, Dayforce has seen five top level executives (including the co-CEO and CFO) resign. For a Company promising investors a bright future, insiders have also been dumping stock. Led by its CEO, **Dayforce insiders have sold over 1.7 million shares of the Company since 2021, reaping gross proceeds of ~ $160 million**. In our view, heavy insider sales, weak internal controls, and high executive turnover are consistent with a Company which we believe engages in next level financial alchemy to mislead investors regarding its profitability, and ties exorbitant executive pay packages to such misleading non-GAAP metrics.

5. **Stock on the Edge of the Precipice**. We believe that Dayforce engages in aggressive accounting maneuvers to inappropriately pull forward revenues, inflate profits, and underreport costs. We also think that it promotes bogus profitability metrics in order to mislead investors, propping up its share price and enriching management whose historically obscene performance packages either directly benefit from these accounting gimmicks or are explicitly tied to these misleading metrics.

   Compared to HCM peers, despite worst-in-class GAAP gross margins, Dayforce trades at an inexplicable premium. We believe that this premium valuation is entirely unjustified and is the result of financial alchemy and accounting gimmicks which have created a lattice structure of misperceptions about Dayforce's business. If Dayforce's stock merely corrected to industry median multiples, we would expect a 25%+ decline in the Company's share price on relative valuation alone.





Source: CapIQ, Sell-Side Reports

But this basic valuation does not reflect on apples-to-apples comparison between Dayforce and its HCM peers, which implies an even more significant downside to the stock. We think investors should adjust Dayforce's profitability to remove the effects of Dayforce's inappropriately pulled forward revenue, accounting gymnastics, float revenue and non-industry standard cost exclusions.

We estimate that on a true apples-to-apples basis, Dayforce currently trades at 38.8x FY23 adjusted EBITDA and 56.9x FY23 adjusted EBIT, meaning that a mere reversion to the peer group multiple would imply over a 51-60% downside for the stock.

$m	
TEV	10,715
FY23 EBITDA	410
Less: est. pull forward revenue	(104)
Less: est. capitalized software cost adjustment	(30)
BOC Adjusted FY23 EBITDA	276
TEV/ BOC Adjusted FY23 EBITDA	**38.8x**
Industry Median EV/LTM EBITDA	19.2x
Implied Downside	**-51%**

$m	
TEV	10,715
FY23 EBIT	340
Less: est. pull forward revenue	(104)
Less: amortization schedule management	(36)
Less: est. capitalized software cost adjustment	(11)
BOC Adjusted FY23 EBIT	188
TEV/ BOC Adjusted FY23 EBIT	**56.9x**
Industry Median EV/LTM EBIT	23.0x
Implied Downside	**-60%**

Source: CapIQ, BOC Adjustments[1]

If we apply the same adjustments to Dayforce's FY24 performance forecast, and value Dayforce on same median EV/ NTM EBIT and EBITDA multiple as its peers, an apples-to-apples comparison would imply up to a 55% downside to Dayforce's stock.

$m	
TEV	10,715
FY24E EBITDA	489
Less: est. pull forward revenue	(104)
Less: est. capitalized software cost adjustment	(30)
BOC Adjusted FY24E EBITDA	355
TEV/ BOC Adjusted FY24E EBITDA	**30.2x**
Industry Median EV/NTM EBITDA	17.7x
Implied Downside	**-42%**

$m	
TEV	10,715
FY24E EBIT	385
Less: est. pull forward revenue	(104)
Less: amortization schedule management	(36)
Less: est. capitalized software cost adjustment	(11)
BOC Adjusted FY24E EBIT	234
TEV/ BOC Adjusted FY24E EBIT	**45.8x**
Industry Median EV/NTM EBIT	20.6x
Implied Downside	**-55%**

Source: CapIQ, BOC Adjustments

But even this is likely conservative, as Dayforce is a governance mess beset by misleading non-GAAP profitability metrics, unusual adverse auditor opinions on internal controls, absurd executive pay packages, insider selling and heavy management turnover. Rather than trade at a premium to other HCM companies, we think that a Company peddling bogus non-GAAP metrics and engaging in accounting gymnastics should trade a steep discount.

We think investors should ultimately see through Dayforce's financial alchemy and that the Company's share price should trade at the discount to other HCM peers it so richly deserves.

[1] Dayforce's peers have different fiscal year end dates, so we use their NTM multiples to value the Company.

1. Inappropriate Revenue Pull Forward Inflates Top Line and Profits

We believe that Dayforce is engaging in highly aggressive and suspect revenue recognition practices to inappropriately pull forward revenue under its contracts, thereby inflating top line growth and profits. We suspect that ongoing concerns about the processes surrounding revenue recognition prompted Dayforce's auditor to take the unusual step of **rescinding** its previous opinion on the Company's internal controls over financial reporting ("ICFR") and then issue an **adverse opinion** in an amended 2023 10-K. This "pulling" of a previously issued clean 2022 opinion came in a highly unusual mid-year update, with one of the material weaknesses that led to the **adverse opinion** on Dayforce's internal controls specifically related to revenue recognition and the allocation of revenues under this framework.

If we adjust Dayforce's financials to remove the effect of what we believe to be inappropriately pulled forward revenue, we estimate that **Dayforce's actual operating profits are 78% less than reported**. Our analysis shatters the narrative that Dayforce has found a sustained path for growth.

- **We Believe that Dayforce Manipulates Revenue Recognition of Professional Services to Inflate Revenue and Profits**

Dayforce categorizes its revenue into two segments. The first is recurring revenues for software services such as Dayforce, Powerpay, and Bureau, recognized monthly over the life of a contract. The second segment is professional services, which are revenues primarily from non-recurring implementation services, typically recognized towards the beginning of a contract. Dayforce reports that professional services account for between 16-19% of total ex. float revenues, an unusually high proportion compared to other HCM companies.

Professional Services and Other Revenues

Professional services and other revenues consist primarily of charges relating to the work performed to assist customers with the planning, design, and implementation of their solutions. Also included in professional services are any related training services, post-implementation professional services, and shipment of time clocks purchased by customers. We also generate professional services and other revenues from custom professional services and consulting services that we provide and for certain third-party services that we arrange for our Other recurring customers. Professional services revenue is primarily recognized as hours are incurred.

Source: Dayforce 2023 10-K

FYE Dec 31	FY18	FY19	FY20	FY21	FY22	FY23
Recurring Services, excl float	558	600	638	810	967	1,129
Professional Services	116	144	152	174	199	216
Total	674	744	790	983	1,166	1,345
Professional Services %	*17.2%*	*19.4%*	*19.3%*	*17.6%*	*17.0%*	*16.1%*

Source: Dayforce Public Filings

When we contacted Dayforce's sales team, they stated that for small to medium customers, Dayforce's core market, customers do not pay for implementation up front.[2] Rather, customers pay a flat monthly rate over the life of the contract, meaning the price of implementation and other professional services is bundled with recurring software services in a flat monthly rate.

This presents an opportunity for manipulation. Even though customers pay in monthly installments over time, Dayforce must model, and use judgment and discretion, for financial reporting purposes, to determine how much revenue it pulls forward and recognize for professional service fees at the beginning of the contract. The Company

[2] Dayforce sales representative stated for larger contracts, the payment terms for implementations mirror those listed on the contract available on the company's website, with 50% due when implementation services commence and the remaining 50% upon completion. Investors should note the more investors paying up front for implementation fees, the more inexplicable Dayforce's reported balance of receivables and contract assets. If the Company's response to our argument is that most of its clients pay for implementation up front (rather than as part of a flat rate bundle over the life of the contract), then it should not report a large and increasing receivables balance. But it does.

has considerable discretion over this calculation because its revenue recognition is based on the **"allocation of the total transaction price to each performance obligation using the respective stand-alone selling prices ('SSP')**."

Revenue Recognition

Description: We recognize revenue for professional services and Cloud subscription services performance obligations based on an allocation of the total transaction price to each performance obligation using the respective stand-alone selling prices ("SSP"). This can result in revenue being recognized in an amount that exceeds the amount we are contractually allowed to bill our customer as of a certain point in time, resulting in the recognition of a contract asset up until the period at which billings are equal to or exceed revenue recognition. We recognized $202.6 million of Cloud professional services revenue for the year ended December 31, 2023, and the related contract assets were $89.0 million as of December 31, 2023.

Source: Dayforce 2023 10-K

It is important to note that stand-alone selling prices (SSPs) are an accounting construct. Dayforce's customers do not know or care what SSP the Company assigns for implementation services because regardless, the customer pays the same flat fee monthly for everything over the life of the contract. While it is irrelevant to the customer, this construct is hugely important to Dayforce's reported financial performance because the **higher the SSP assigned by the Company for professional services and the more hours Dayforce estimates will be required for the implementation, the more revenue, by accounting magic, Dayforce recognizes for professional services at the beginning of a contract**.

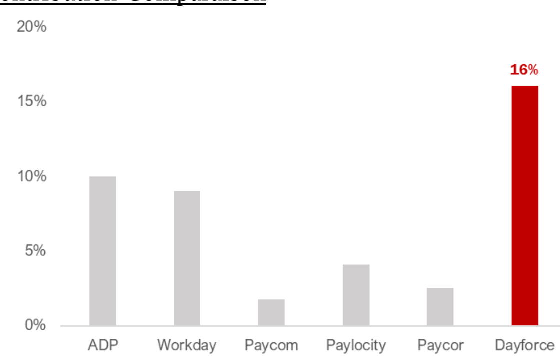
- **Dayforce's Financial Statements are an Inexplicable Outlier Amid Pivot to Systems Integrators**

First, it is critical to note that Dayforce recognizes substantially more professional service revenue as a proportion of total ex. float revenue than all other HCM peers. Why is it that? In our view, the simple explanation is that Dayforce is abusing its discretion over SSPs to pull forward and recognize an inappropriate amount of a contract's value as implementation revenue.

Industry leading peers Workday and ADP report that professional services comprise less than 10% of total revenues. For Paycom, Paylocity and Paycor, the percentage is even lower, approximately 2-4% of total revenue ex. float. Yet, inexplicably, Dayforce reports that professional services revenues make up between 16-19% of total ex. float revenues over recent years. This is almost double the amount of professional services revenue recognized by industry leaders such as ADP and Workday, and exorbitantly higher than the remaining HCM peers.

Professional Service Revenue Contribution Comparaison

	2018	2019	2020	2021	2022	LTM
ADP						>10%
Workday	15.5%	14.6%	12.3%	11.5%	10.4%	9.0%
Paycom	1.6%	1.8%	1.9%	1.8%	1.7%	1.7%
Paylocity	2.4%	3.7%	3.5%	3.5%	3.8%	4.1%
Paycor		2.4%	4.0%	2.9%	2.5%	2.5%
Median	2.4%	3.0%	3.7%	3.2%	3.1%	3.3%
Dayforce	**17.2%**	**19.4%**	**19.3%**	**17.6%**	**17.0%**	**16.1%**



Source: Companies Public Filings and Earnings Calls[3]

Yet Dayforce's financials are even more suspicious considering that in recent quarters, Dayforce has pivoted away from directly performing the software implementations for new clients and, instead, now outsources much of this work to unrelated third parties, known as systems integrators. In theory, this should lower the Company's professional service revenue contribution, as its CEO stated on its Q2 2023 earnings call.

[3] In its earnings call in January 2024, ADP's CFO stated that implementation revenue accounted for sub-10% of its overall revenue. Its investor relation stated that the actual percentage is even lower than that.

David D. Ossip
Chairman & Co-CEO

One thing I would add to that is if you actually look at the number of projects that were kicked off by SIs in the quarter, it grows to 35% on a global basis, which is up obviously significantly year-over-year. You'll also see that reflected if you do the breakdown of our total revenue line, you'll see that we're shifting the professional services now more towards the actual SIs. And as you go forward, you would expect less and less of our revenue -- total revenues, fee from professional services as our hope would be that we focus on becoming a scalable software company, leveraging our SI partners to do the majority of the implementation.

Source: Q2 2023 Earnings Call, Aug 02, 2023

On the FY 2023 Q4 earnings call, management stated that at least 50% of new customers are onboarded through third- parties. For comparison, this figure only stood at 35% in Q2 2023 and ~15% in Q4 2022.

David D. Ossip
Chairman & CEO

Look, as you know, we guide very narrow. I can say you expect as we get into the year, the numbers should come within guide, which it did, which I think is a reflection of a well-managed and very predictable type of business. As Steve called out, we were very happy with the go-lives that we saw in the quarter. In fact, they came in ahead of what we had internally budgeted. It's also impressive given the fact that we now have at least half of the deals that we're implementing run by the system integrators where they're priming actual implementations. And that, I think, is a reflection on the robustness of the software that it's not only us that can implement that we're finding that our system integrated partners are able to implement and to implement predictably be on time, which I think is a very good testament. But Jeremy, anything else that you'll call out.

Source: Q4 2023 Earnings Call, February 7, 2024

Dayforce's CEO explicitly stated that more outsourcing to systems integrators would lead to lower professional services revenues. After all, Dayforce is no longer doing the work.

But this is not the case. Professional services revenue as a percentage of total revenue increased in Q4 2023, even though the Company is outsourcing more than 50% of its software implementation projects.

$m	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Total recurring revenue, ex. Float	237	236	243	252	271	273	287	298
Total professional services	45	50	52	51	53	51	52	61
Total revenue, ex. Float	282	287	294	303	324	324	339	359
% of professional services	*16.1%*	*17.5%*	*17.6%*	*16.9%*	*16.3%*	*15.7%*	*15.4%*	*16.9%*
% implementations kicked off by system integrators				~15%		35%		>50%

Source: Dayforce Public Filings, Earnings Calls

Given the pivot to systems integrators, professional services as a percentage of revenue should be coming down significantly as Dayforce outsources more than half of implementations to third parties. Yet Dayforce's recognition of professional service revenues is magically increasing.

The obvious and likely explanation, in our view, is that just as its auditors seemed to have warned, Dayforce is inappropriately pulling forward increasing amount of revenue into early contract periods. We think the Company is using (and abusing) its discretion under the stand-alone selling price modeling process to categorize more of a contract's value as professional services. This would explain why Dayforce recognizes far more professional services as a percentage of total revenue than its peers and why professional service revenue is inexplicably increasing despite outsourcing more work to third parties. It would also explain the mysterious, and growing, balance of contract assets on its balance sheet.

- **Mysterious and Growing Balance of Contract Assets**

On its balance sheet, Dayforce reports a mysterious and growing balance of contract assets, created when the amount of revenue recognized by the Company **"exceeds the amount we are contractually allowed to bill our customers."** It is a complex and somewhat confounding concept. It is effectively unbilled revenue, and the balance is growing because the Company is recognizing more revenue than it is contractually entitled to bill its customers.

Notably, Dayforce states explicitly that these contract assets are related to revenue recognized for professional services, the exact area its auditors warned about in "Critical Audit Matters" since its 2019 10-K. This is the same accounting process that we believe is being used to inappropriately pull forward revenue.

Revenue Recognition

Description: We recognize revenue for professional services and Cloud subscription services performance obligations based on an allocation of the total transaction price to each performance obligation using the respective stand-alone selling prices ("SSP"). This can result in revenue being recognized in an amount that exceeds the amount we are contractually allowed to bill our customer as of a certain point in time, resulting in the recognition of a contract asset up until the period at which billings are equal to or exceed revenue recognition. We recognized $202.6 million of Cloud professional services revenue for the year ended December 31, 2023, and the related contract assets were $89.0 million as of December 31, 2023.

Source: Dayforce 2023 10-K

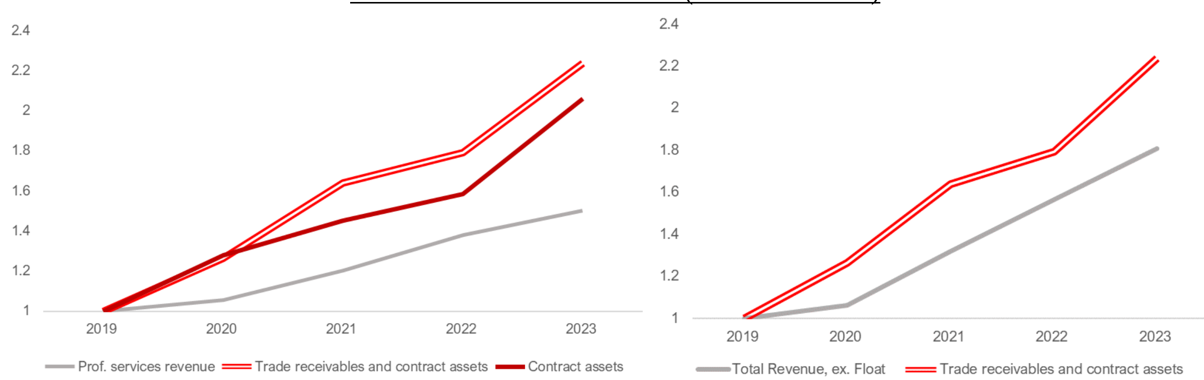
To our knowledge, Dayforce is one of only two HCM companies that recognize contract assets, and the only one to recognize a significant amount of contract assets on their balance sheets.[4] HCM businesses, including Dayforce, are generally paid by customers in advance or when the service is performed (including payroll). As a result, HCM businesses are expected to have small accounts receivables balances, and not large and growing balances of unbilled revenue in the form of contract assets.

However, Dayforce has reported an ever-increasing balance of unbilled revenue in the form of contract assets, which have doubled from $43 million in FY 2019, to $89 million in 2023. Combined with traditional accounts receivables, Dayforce's balances suggest that the Company is increasingly recognizing revenue long before, and in significant excess of, its contractual entitlement to bill its customers.

	2019	2020	2021	2022	2023	%Change
Reported Revenue, ex. Float	744	790	983	1,166	1,345	81%
Professional services revenue	144	152	174	199	216	50%
Trade receivables, net and contract assets	113	143	185	202	253	124%
Contract assets	43	55	63	69	89	106%

Source: Company Public Filings

Dayforce's Receivables and Contract Assets
Grows Faster than its Revenue (Rebased in 2019)



Source: Company Public Filings

[4] Workday reported contract assets for the first time in its FY24 10-K. Unlike Dayforce, nearly all of Workday's contract assets are included in its trade and other receivables balance. This is in stark contrast to Dayforce which does not include them as accounts receivables.

In short, we believe that the increasing balance of contract assets is strong evidence that Dayforce is becoming more aggressive in pulling forward revenues under the guise of professional services, inflating revenues and, as we will discuss below, profits.[5]

Dayforce's growing balance of contract assets is problematic for other reasons. First, these contract assets are not recognized under accounts receivables, but rather under other asset items. Investors would not typically include these in a DSO calculation without a detailed read of its financial statements. Notably, contract assets are excluded from DSOs in the sell side reports we reviewed and by major financial data providers Bloomberg and CapIQ, suggesting that investors are largely unaware of this issue.

- **Surprise: Auditor Rescinds Opinion Mid-Year in Strange 10-K Amendment!**

Dayforce's auditor has already been flagging the Company's revenue recognition policy for professional services as an issue since its FY 2019 10-K, when its auditor first listed revenue recognition from the estimate of SSPs for professional services as a Critical Audit Matter.

Critical Audit Matters

Stand-alone selling price (SSP) of cloud Dayforce professional services

As discussed in Note 12 to the consolidated financial statements, the Company recognized $216.4 million of professional services and other revenue, including cloud Dayforce professional services, for the year ended December 31, 2023, and $89.0 million of contract assets as of December 31, 2023. Cloud Dayforce professional services includes implementation services to activate new accounts. The Company's cloud services arrangements include multiple performance obligations and the transaction price allocation is based on the SSP for the performance obligations. The SSP for cloud Dayforce implementation services is estimated based on market conditions and observable inputs, including rates charged by third parties to perform implementation services, as well as an estimate of the hours expected to be incurred.

We identified the assessment of the Company's estimated hours expected to be incurred that were used to determine the SSP of cloud Dayforce implementation services as a critical audit matter. Subjective auditor judgment was required to evaluate the professional services hours assumption that involved unobservable market data and was susceptible to manipulation.

Source: Dayforce 2023 10-K

But then, almost unnoticed by investors, the auditor dropped the hammer. In November 2023, along with its delayed quarterly report, Dayforce also filed a surprise amendment to the Company's previously issued 2022 10-K.

In this amended 10-K, the Company disclosed that its auditor not only **rescinded** its previous clean opinion but expressed a **new adverse opinion** on the effectiveness of Dayforce's internal controls over financial reporting **specifically regarding the calculation of the Company's professional service revenue**.

[5] Dayforce's disclosures regarding its contract assets are confusing and, on the surface, somewhat contradictory. For example, in its 2023 10-K, the Company states contract assets are the products of recognizing more revenue than it is contractually allowed to bill its customers. Yet in the same filing, Dayforce includes a seemingly contradictory and confounding sentence stating: "Contract assets expected to be recognized in revenue within twelve months are included within Prepaid expenses and other current assets, with the remaining contract assets included within Other assets on our consolidated balance sheets." This disclosure is confusing, because on the surface it implies that some contract assets are recognized before the company recognizes revenues. We think this ambiguous disclosure is likely a mistake (mixing up revenue and receivables) because it contradicts the company's previous disclosure as to when contract assets are created (i.e., when the company recognizes more revenues than it is contractually entitled to bill its customers). We reconcile this contradiction by taking the Company's more complete disclosure at face value, because under ASC606, we think it is clear that contract assets and corresponding revenue are recognized in the same period.

2022 10-K

RESCINDEDE

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the resu its operations and its cash flows for each of the years in the three-year period ended December 3 2022, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022 based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

2022 10-K/A

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2023, except for the restatement as to the effectiveness of internal control over financial reporting for the material weaknesses related to cash and cash equivalents and obligations of Canada customer funds and certain revenue accounts, as to which the date is November 13, 2023, expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

Further, while reassessing the effectiveness of the Company's internal control over financial reporting, management identified, in the aggregate, a material weakness related to controls over certain Professional Services and Powerpay revenue accounts as of December 31, 2022, resulting from an ineffective risk assessment process to properly design and implement controls over (1) certain process level activities related to Powerpay revenue, and (2) information technology access pertaining to a system implemented in September 2022 that adversely impacted the accuracy and completeness of information that is used to measure a component of its Professional Services revenue.

Source: Dayforce 2022 10-K, 2022 10-K/A

In our experience, it is highly unusual for an auditor to rescind an opinion over a company's financial controls in an amended 10-K. After all, the previous year's annual report was already closed, issued, and filed with the SEC. Yet eight months after the Company's 10-K was already issued, Dayforce's auditor went back and expressed an **adverse opinion over the Company's internal controls**. For a company of Dayforce's size and market capitalization, such an amendment appears highly unusual.

Amended 10-Ks have sadly become a venue for companies to sneak in bad news. For example, now bankrupt Lordstown Motors filed an amended 10-K in June 2021 to disclose the ineffectiveness of its internal controls over financial reporting in the previous year.

Even more unusual is that when the auditors rescinded their previous clean opinion of the Dayforce's internal controls, the auditor highlighted the ineffectiveness of the Company's process and control related to the measurement of professional service revenues. The auditor even flagged that such weaknesses "**adversely impacted the accuracy and completeness of information that is used to measure a component of its Professional Services revenue**."

Dayforce's recent 2023 10-K claimed that it remediated the internal control issue with respect to professional services, yet the auditors maintained their adverse opinion on the Company's internal controls in part on the grounds that Dayforce lacks control over IT systems supporting other functions. Critically, management stated in the 2023 10-K that Dayforce does not yet know the impact from this problem on its financial statements. It is perplexing that a S&P 500 company does not have effective internal controls for two consecutive years and lacks the resources to assess the impact of these issues on its financial statements. We question whether there is an internal or external inquiry taking place and what, if any, restatements will result from this lengthy and unusual problem.

We believe that the auditors' mid-year rescission of a previous opinion was a warning to investors that Dayforce was becoming more aggressive with pulling forward revenue by inflating the SSPs of professional services, thereby inflating the amount of revenue Dayforce recognizes at the beginning of the contract.

- **We Estimate that the Actual Operating Profits are 78% Less than Reported.**

We suspect that the purpose of these accounting gimmicks is twofold. First, the Company is able to pull forward revenue from future years into the current period. This inflates revenues and reported top line growth. Second, and more importantly, we believe that this aggressive practice inflates Dayforce's profits, by pulling forward revenue to offset other expenses incurred by the Company in the current period.

We can estimate the effect of Dayforce's aggressive accounting by comparing the Company to its peers. Workday disclosed that its professional services revenue accounted for 9% of total revenue. If we generously assume that Dayforce's professional service revenue contribution should align with Workday, over the last twelve months we estimate that Dayforce inappropriately pulled forward an additional $104 million of ex. float revenue forward.

But the impact is even more significant on profits. Since increasing the estimate of stand-alone selling price does not affect the costs incurred in the period, we believe that the revenue pulled forward by this accounting maneuver is effectively 100% margin. In 2023, Dayforce claimed its operating profits were $133 million, the highest since the Company went public. Yet when we adjust for what we estimate to be inappropriately pulled forward revenue, we estimate that Dayforce's actual operating profits were **78% less than the Company's reported figure.**

$m	Reported	Adjustments	Adjusted	% change
Recurring revenue, ex. float	1,129		1,129	
Professional services revenue	216	(104)	112	-48%
Float revenue	169		169	
Total revenue	1,514	(104)	1,409	-7%
Cost of sales	(867)		(867)	
Gross profit	647	(104)	542	-16%
SG&A	(513)		(513)	
Operating profit (loss)	133	(104)	29	-78%
EBITDA	265	(104)	160	-39%
Adjusted EBITDA	410	(104)	306	-25%

Source: Company Public Filings, BOC Estimates[6]

If we simply normalize Dayforce's professional service revenues to Workday, a generous comparison to the industry leader, we estimate that Dayforce's actual operating profits were 78% less than the Company's reported figure.

To us the story is simple. The Company's SSPs and the allocation of contract revenues to professional services are highly discretionary, and thus vulnerable to manipulation. We believe that Dayforce abuses this discretion to allocate more of the lifetime value of its contracts into the first year. This explains not only the Company's elevated balance of contract assets but also why the proportion of professional service revenues recognized each year is both an outlier among peers and inconsistent with the Company's pivot towards outsourcing software implementations using systems integrators.

We suspect that the Company's increasingly aggressive revenue recognition using this accounting magic contributed to the circumstances around which its auditor took the highly unusual step of insisting on a mid-year amendment to the previous 10-K and rescinding its previous clean ICFR opinion to issue a new adverse opinion on Dayforce's internal controls.

In our view, not only do such accounting maneuvers give investors a misleading view of the Company's profitability but they provide a windfall to management whose compensation is tied to such aggressive and inappropriate revenue recognition policies.

[6] We estimate professional services revenue by adjusting the proportion from 16% ex float as reported, to the next highest competitor, Workday (9% of total rev. ex float). This is likely conservative and overly generous to the Company, as the industry median for the percentage of professional service revenues recognized by HCM companies is far less than our benchmark of 9%.

2. Misleading Investors on "Most Important" Profitability Metric

Dayforce currently trades at a premium valuation to other HCM companies, we believe, because investors have been misled by Dayforce's accounting gimmicks and its hyper-promotional non-GAAP profitability metrics.

These key metrics appear highly manipulated using non-industry standard inclusions (float revenue) or arbitrary cost exclusions. Management then issues itself exorbitant compensation rewards tied to these misleading profitability metrics. All the while, Dayforce reports pedestrian results and chronic unprofitability. By promoting these bogus statistics, we think investors are misled about Dayforce's true profitability while management is unjustly enriched at the expense of shareholders.

- **Bogus Profitability Metrics Dress Up Worst-in-Class GAAP Gross Margins**

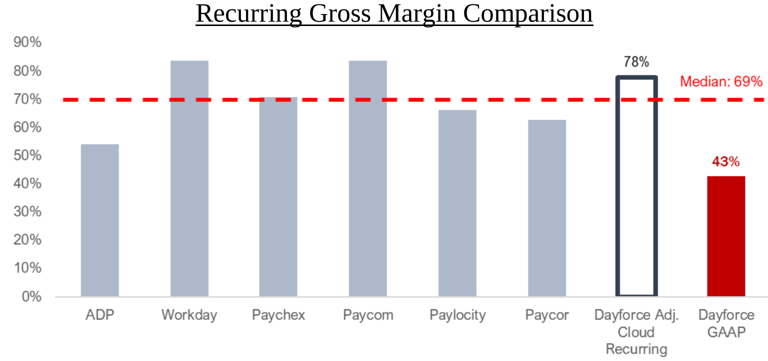
With a GAAP gross margin of ~40%, Dayforce's profitability is easily the worst among its HCM peer group. To deflect attention away from this uncomfortable fact, management directs investors' attention to a loosely defined non-GAAP metric: **adjusted cloud recurring gross margin**.[7] For example, on a recent earning call, Dayforce's chairman and CEO immediately diverted the conversation away from GAAP gross profits to adjusted cloud recurring gross margin, which he characterized as the Company's "**most important metric**."

> Congratulations to the team on the big increase in terms of profitability. One thing I was really impressed by was you ended up having a 53% increase in terms of gross profit on a year-over-year basis across the consolidated operations, and yet SG&A was essentially flat to down a little bit leading to this rapid increase in terms of operating profit on a GAAP basis.
>
> Can you talk a little bit about the areas of leverage, particularly on the SG&A? Like what did you end up skinning down? And how should we think about those efficiency targets moving throughout the year because that was really impressive?
>
> **David D. Ossip**
> *Chairman & Co-CEO*
> Thanks for that, Mark. Appreciate it. As you know, we've been quite focused on the bottom line and driving efficiencies across the business. First of all, I'd point out that if you look at the most important metric, which is the cloud recurring gross margin, that was up 320 basis points year-over-year to 78.7%. One of our targets that we've communicated to the market is getting that number to above 80%. And you can see that we have obviously a direct line of sight to that.

Source: Dayforce 1Q23 Earnings Call

In theory, this metric is supposed to justify Dayforce's premium valuation by convincing investors that the Company is transitioning to a high-gross margin SaaS business with a valuable moat of recurring revenues. Under GAAP, Dayforce's gross margins trail far behind the comps. Yet after financial alchemy, Dayforce's adjusted cloud recurring gross margins would appear put Dayforce ahead of its HCM peers.

Recurring Gross Margin Comparison



Source: Companies public filings subject to certain non-GAAP adjustments[8]

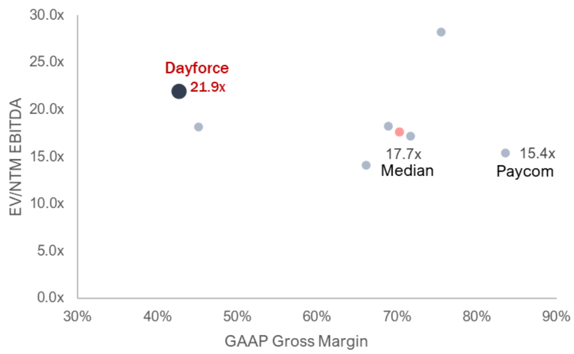
[7] This metric is Dayforce's recurring gross margin on steroids as it excludes the performance of its lower margin recurring business, share-based compensation, and certain other costs in order to mask the anemic profitability of its underlying business.
[8] All of Dayforce's peers, except Paycom, exclude float revenue from the calculation of recurring gross margin or recurring revenue. For ADP, we adjusted its PEO zero-margin benefits pass-throughs, as this was not recurring revenue. ADP's margin also includes implementation revenue, so we believe its actual recurring gross margins would be even higher than what we calculated.

We think this explains why, despite worst in class GAAP gross margins, Dayforce trades above its peer group in terms of relative valuation. Dayforce trades at a nosebleed EV/EBITDA multiple of 26.1x while its competitors trade at a median multiple of 19.2x.

Company	Market Cap	TTM Gross Margin	TTM EBITDA Margin	EV/TTM EBITDA	EV/NTM Rev	EV/NTM EBITDA	Price/TTM FCF
ADP	100,697	45%	27%	20.1x	5.2x	18.1x	31.5x
Workday	70,971	76%	28%	32.9x	7.9x	28.2x	35.4x
Paychex	43,289	72%	45%	18.3x	7.8x	17.2x	28.2x
Paycom	11,363	84%	42%	15.5x	6.0x	15.4x	34.4x
Paylocity	9,372	69%	35%	20.2x	6.2x	18.2x	36.3x
Paycor	3,205	66%	31%	16.9x	4.5x	14.0x	26.2x
Median		**70%**	**33%**	**19.2x**	**6.1x**	**17.7x**	**33.0x**
Dayforce	**10,042**	**43%**	**27%**	**26.1x**	**6.2x**	**21.9x**	**98.0x**

Source: Capital IQ

Dayforce Trades at a Premium EV/ NTM EBITDA Multiple



Source: Capital IQ

Yet unpack this critical profitability metric and it appears, in our opinion, to be a misleading attempt to set up an apples-to-oranges comparison with other HCM companies. We believe that this has the effect of propping up Dayforce's undeserved premium valuation and enriching management whose compensation is tied to this nonsense profitability metric.

- **Manipulated Metric Arbitrarily Excludes Critical Costs of Recurring Revenues**

Compared to its peers, Dayforce's highly aggressive calculation appears to be an outlier, both overcounting revenue and undercounting costs.

At a high level, Dayforce allocates ~85% of reported revenues to its recurring segment, but only ~40% of costs. The percentage of the costs excluded from the calculation has only grown over time, as we believe the Company has become increasingly desperate to feign profitability.

$m	2018	2019	2020	2021	2022	2023
Total Revenue	741	824	843	1,024	1,246	1,514
Recurring	625	680	690	851	1,048	1,297
% of total revenue	***84%***	***83%***	***82%***	***83%***	***84%***	***86%***
Total cost of revenue	(426)	(456)	(501)	(642)	(773)	(867)
Recurring	(200)	(202)	(213)	(262)	(309)	(325)
% of total cost of revenue	***47%***	***44%***	***43%***	***41%***	***40%***	***37%***

Source: Company Public Filings

Dayforce reports four components in its cost of revenue: recurring costs (or at least what it characterizes as recurring costs), costs of professional services and other, product development and management costs, and depreciation and amortization.

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2023	2022	2023	2022
(In millions, except per share data)				
Revenue:				
Recurring	$ 339.1	$ 284.8	$ 1,297.3	$ 1,047.6
Professional services and other	60.6	51.3	216.4	198.6
Total revenue	399.7	336.1	1,513.7	1,246.2
Cost of revenue:				
Recurring	85.5	75.0	324.9	309.4
Professional services and other	68.6	66.1	265.6	238.7
Product development and management	56.4	44.9	209.9	169.9
Depreciation and amortization	19.4	15.0	66.8	55.0
Total cost of revenue	229.9	201.0	867.2	773.0
Gross profit	169.8	135.1	646.5	473.2

Source: Dayforce FY2023 Results

Critically, Dayforce excludes costs associated with the management of its products from its calculation of recurring gross margins. These are not small dollars. For example, in 2023, the Company reported $210 million of product development and management costs, almost half of which were product management costs which we do not believe should be excluded from the calculation of recurring gross margins.

> Product development and management expense includes costs related to software development activities that do not qualify for capitalization, such as development, quality assurance, testing of new technologies, and enhancements to our existing solutions that do not result in additional functionality. Product development and management expense also includes costs related to the management of our solutions. Research and development expense was $112.0 million, $92.3 million, and $81.1 million for the years ended December 31, 2023, 2022, and 2021, respectively.

Source: Dayforce FY2023 10-K

We believe that Dayforce is inappropriately excluding expenses related to the ongoing management of its products and solutions, which in our view are clearly recurring costs of running its underlying business. By arbitrarily removing such costs from the calculation of recurring margins, especially costs that are included by Dayforce's competitors, we believe that Dayforce misleads investors with respect to its key profitability metric.

In addition, Dayforce also excludes depreciation and amortization costs from the calculation of recurring gross margins, even though the majority of its peers do not exclude such costs when presenting recurring gross margins.

> Gross profit and gross margin. The following table presents total gross margin and solution gross margins for the periods presented:

	Year Ended December 31,	
	2023	2022
Total gross margin	42.7 %	38.0 %
Gross margin by solution:		
Cloud recurring	77.0 %	72.0 %
Other recurring	46.0 %	60.5 %
Professional services and other	(22.7)%	(20.2)%

> Total gross margin is defined as total gross profit as a percentage of total revenue, which is inclusive of product development and management costs, as well as depreciation and amortization associated with cost of revenue. Gross margin for each solution in the table above is defined as total revenue less cost of revenue for the applicable solution as a percentage of total revenue for that related solution, which is exclusive of any product development and management or depreciation and amortization cost allocations.

Source: Dayforce 2023 10-K

In our view, it is pure financial alchemy by which Dayforce magically converts an industry worst ~40% GAAP gross margin into a near industry leading 78% adjusted cloud recurring gross margin.

- **Dayforce's Inclusion of Float Revenue is also Extraordinarily Aggressive**

But Dayforce does not just undercount and exclude costs, we believe its "most important" profitability metric also overcounts revenue.

Dayforce's core business generates recurring revenue from charging customers monthly fees to use its software. However, as part of its payroll and tax filing services, the Company collects funds for payment of payroll and taxes from its customers in advance. Dayforce then invests these customer funds into various fixed income instruments. This generates a secondary stream of investment income that the Company refers to as float revenue.

Unlike other HCM peers, except for Paycom, Dayforce includes float revenue as a component of recurring revenue, even though it has little to do with the Company's recurring software business. In our opinion, float revenue is neither "Cloud" nor "SaaS" revenue and should be an entirely separate non-operating revenue item.

Dayforce also reports far more float revenue than any of its peers as a percentage of total revenue and EBITDA. This raises questions of how aggressively Dayforce is investing to generate such returns, and why, in an environment of elevated interest rates, would customers continue to float Dayforce so much money when, if they used a competitor, customers could presumably keep more of the interest income for themselves.

Company	Float Rev. as % of TTM Rev.	Float Rev. as % of TTM EBITDA
ADP	5%	18%
Workday	0%	0%
Paychex	2%	5%
Paycom	Undisclosed	Undisclosed
Paylocity	8%	24%
Paycor	7%	24%
Median	**5%**	**18%**
Dayforce	**11%**	**41%**

Source: Companies Public Filings

Because float revenue represents a zero-cost stream of investment income, we believe its inappropriate inclusion in recurring revenue skews the Company's recurring gross margin significantly upwards. Because most of other HCM peers do not include float revenue in their presentation of recurring revenue, Dayforce appears to be more profitable by comparison, which we believe is one of the reasons it trades at an unjustified premium to comps.

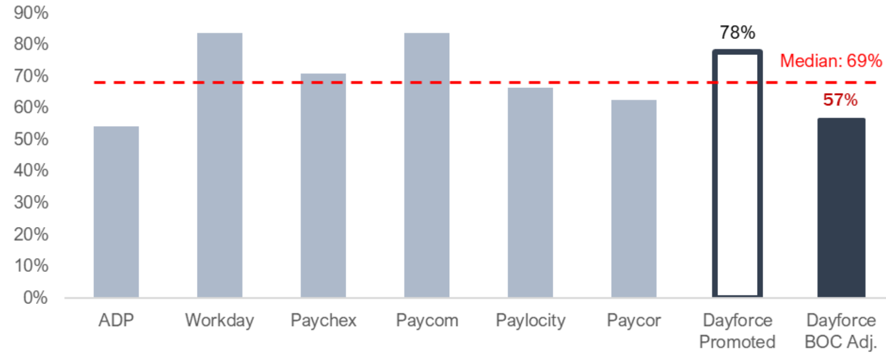
After adjusting the Company's recurring gross margin for inappropriately included float revenue and excluded costs, we estimate that Dayforce's **gross margin for its recurring business is only 57%**, which is significantly lower than its self-promoting metric.

$m	2023
Reported Recurring revenue	1,297
Float revenue	(169)
Recurring revenue, ex. float	1,129
Cost of recurring	(325)
Product management costs	(98)
Depreciation and Amortization	(67)
Actual cost of recurring revenue	(490)
BOC Adjusted Recurring Revenue Gross Profit	639
BOC Adjusted Recurring Revenue Gross Margin	***57%***

Source: Company Public Filings; Blue Orca Calculation

On an apples-to-apples basis, when we use the same methodology to compare Dayforce's recurring gross margin to its competitors', the Company's profitability appears to be worst in class.

Apples-to-apples Calculation Shows Dayforce's
Recurring Gross Margin is Significantly Lower than Peers



Source: Companies Public Filings; Blue Orca Calculation

Not only do we believe that Dayforce's bogus non-GAAP profitability metrics mislead investors, but such metrics unjustly enrich management whose compensation is tied to them.

- **Management Compensation Tied to Misleading Non-GAAP Profitability Metric**

In the past few years, financial media has loudly called out Dayforce's egregious executive compensation packages, made all the worse by the Company's lackluster performance since its IPO.


BUSINESS

Ceridian HCM's co-CEO made $120.5M last year

David Ossip was likely Minnesota's highest paid executive in 2021. His salary was $775,000, but he exercised more than $100 million in stock options.

By Patrick Kennedy Star Tribune | MARCH 25, 2022 — 7:34AM

Source: *Star Tribune, March 25, 2022*


What to give a CEO with millions in stock? Millions more

DAVID MILSTEAD >
PUBLISHED MARCH 18, 2021

Source: *The Globe and Mail, March 18, 2021*

It is not hard to see why Dayforce has become a poster child for corporate greed. In 2019, the CEO rewarded himself with a special grant of 1 million options under the flimsy justification that it was "in recognition of Dayforce being a founder led, high growth company," and another 750,000 options "in recognition of our exceptional organizational performance in 2018 under his leadership."[9] The CEO's options were valued at $28.6 million by the Company. However, Institutional Shareholder Services valued the options at $50.3 million and recommended that shareholders reject the compensation plan. The plan was ultimately narrowly passed, with just under half of all reporting

[9] On March 20, 2019, "Mr. Ossip was granted 1,000,000 stock options in recognition of Dayforce being a founder led, high growth company, and 750,000 stock options in recognition of our exceptional organizational performance in 2018 under his leadership, which included a successful IPO, the creation of significant increases in stockholder value through his leadership and management of the organization, and his enhancement of the executive leadership of Dayforce to provide for future growth and scale."

shareholders voting against it.[10] Despite such pushback, Dayforce's CEO was still somehow ranked as the 33rd highest paid CEO in the US in 2019, higher than Target's CEO.

ISS gave Ceridian its lowest possible score for its 2019 compensation practices and recommended a "no" vote, saying "limited rationale was provided for the significant increase in the size of the CEO's equity awards," and Mr. Ossip's pay was "significantly higher" than at peers. In 2019, Ceridian gave Mr. Ossip 1.76 million options it valued at US$28.6-million – although ISS, using different assumptions, valued it at US$50.3-million.

Source: The Globe and Mail

Investors were clearly uncomfortable with management's level of self-enrichment despite Dayforce's poor results, yet greed went into overdrive in the following year.

Despite missing its performance targets across the board, and executives therefore receiving no cash payouts tied to the stated incentive plan, Dayforce still granted management "a discretionary cash bonus" of 70% of their original 2020 incentive plan target. The CEO was also given yet another "one-time" grant of 1.5 million options, valued at $22.5 million by the Company, for the seemingly unnecessary goal "to both retain and motivate Mr. Ossip to focus on strategic and growth opportunities…."

Major Shareholders Complained Dayforce Gave Too Many Stock Options to CEO

In its proxy statement, Ceridian said management or board members spoke to shareholders that owned 69 per cent of the company's shares as part of a shareholder outreach campaign last year, and were told it had been giving Mr. Ossip too many stock options. Shareholders said the company needed to better link pay to performance. Some of those meetings occurred before it made the special 2020 option award.

Source: The Globe and Mail, March 18, 2021

This pushed investors over the top: Dayforce's executive compensation plan was overwhelmingly voted down by a vote of 98.6 million to 34.8 million after extensive public criticism. It is exceedingly rare for the compensation plans of publicly traded companies to be rejected by shareholders. That year, only ~20 companies in the S&P 500 had shareholders vote down executive pay packages.

Despite shareholders rejecting the plan, Dayforce's CEO was still one of the highest paid executives for a public Company of this size. In total, **while Dayforce lost $75 million in 2021, its CEO received $120.5 million in compensation** that year. This lavish compensation received considerable negative media attention.

David Ossip, co-CEO of Ceridian, was the highest paid Minnesota public company executive in 2020 and is likely to be again in 2021.

David Ossip Chairman and co-CEO Ceridian HCM Holding • **Total compensation for year ended Dec. 31:** $120,532,143 • **Salary:** $775,000 • **Non-equity incentive pay:** $400,000 • **Other compensation:** $51,727 • **Exercised stock options:** $107,835,000	David Ossip Chairman and co-CEO Ceridian HCM Holding • **Value realized on vesting shares:** $11,470,416 • **New stock options:** 226,931 • **CEO pay ratio:** 127 to 1 • **Median employee pay:** $83,919 • **Total 2021 shareholder return:** -2.0%

Source: StarTribune

[10] The 2019 voting results showed that 46% of owners voted against on the compensation of Dayforce's Names Executive Officers. (For: 74,203,663 vs Against: 64,121,935)

Notably, after shareholders nearly rejected management's compensation plan, the Company was forced to retreat from some of its most aggressive incentive metrics. In the Company's 2022 proxy statement, float revenue was excluded from statistics that determined management compensation.

2022 Proxy Statement

- Reviewed annually
- 2021 MIP variable compensation in the form of 50% cash and 50% PSUs
- Based on the achievement of financial performance goals established annually in the first quarter
- 2021 MIP financial performance metrics were cloud revenue excluding float and adjusted EBITDA margin excluding float
- 2021 SIP financial performance metrics (only for EVP, Chief Revenue Officer) were cloud per employee per month ("PEPM") sales

Source: Dayforce 2022 Proxy Statement

But the retrenchment appears not to have lasted for long. After the Company's float revenue almost doubled due to rising interest rates, management has once again included float revenue in performance metrics which determine compensation.[11]

Ceridian HCM Holding Inc. 2023 Management Incentive Plan

Receipt of performance based, incentive compensation under the 2023 MIP is based on the Company's achievement of the following financial goals: (i) the Cloud Revenue financial goal (the "Cloud Revenue Goal"); (ii) the adjusted EBITDA financial goal (the "Adjusted EBITDA Goal"); and (iii) the Sales Per Employee Per Month ("PEPM") Annual Contract Value ("ACV") financial goal (the "Sales PEPM ACV Goal") for fiscal year 2023 (collectively, the "Performance Goals"). Both the Cloud Revenue Goal and the Adjusted EBITDA Goal are calculated based on the Company's operating results on a constant currency basis and includes float revenue based on using average budget yield rates and actual volume. The Sales PEPM ACV Goal is calculated based on the sales of the Company's products on a constant currency basis that contribute to its Cloud recurring revenue. In addition to the Performance Goals,

Source: Dayforce 8-K, March 1, 2023

In Q1 2023, Dayforce introduced **adjusted cloud recurring gross margins (including float revenue)** into the compensation plan of certain executives, including its current CEO. This was surprising given that shareholders had previously rejected a proposed executive compensation plan under which management was compensated for float interest, likely in part because float revenue has little to do with management effectiveness or the performance of the underlying business. But as float revenue became an increasingly large percentage of Dayforce's profitability, it appears that management could not resist the temptation to shoehorn it back into their compensation plan.

Grant of Equity Awards to Certain Members of Management

The vesting of all of the fPSU awards for Mr. Ossip, Ms. Turner, Ms. Heuland, Mr. Armstrong and Mr. Korngiebel, and \$2.0 million of Mr. Holdridge's \$2.85 million fPSU award is based on the Company's achievement of the following financial goals, all weighted equally: (i) the Cloud Recurring Revenue financial goal (the "Cloud Recurring Revenue Goal"); (ii) the Adjusted Cloud Recurring Gross Margin financial goal (the "Adjusted Cloud Recurring Gross Margin Goal"); and (iii) the Sales PEPM ACV Goal (collectively, the "fPSU Performance Goals"), with each goal measured independently to determine achievement and with intermediate vesting being linearly interpolated.

Both the Cloud Recurring Revenue Goal and the Adjusted Cloud Recurring Gross Margin Goal are calculated based on the Company's operating results on a constant currency basis and include float revenue based on using average budget yield rates and actual volume. The Sales PEPM ACV Goal is calculated based on the sales of the Company's products on a constant currency basis that contribute to its Cloud recurring revenue.

Source: Dayforce 8-K, March 1, 2023

We suspect that the re-inclusion of float revenue is particularly controversial, because in the proposed 2024 management incentive plan, it appears to have been removed again. Yet this does not change the fact that management's 2023 compensation, set to be voted upon at the upcoming shareholder meeting, not only counts float revenue but is tied to a nonsense non-GAAP metric which we believe arbitrarily excludes recurring expenses and inflates Dayforce's profitability.

[11] Float revenue was \$41 million in 2021, \$82 million in 2022, and \$169 million in 2023.

In sum, Dayforce is a pedestrian HCM business with near worst in class GAAP gross margins compared to other players in the industry. To distract investors from this reality, we believe the Company's management promotes bogus non-GAAP metrics such as "adjusted cloud recurring gross margins" as its most important performance indicator. However, this metric appears highly manipulated using non-industry standard inclusions (float revenue) and arbitrary exclusions of what appear to be recurring costs. By promoting these metrics, at management's direction, we think investors are misled about Dayforce's true profitability while management is unjustly enriched at the expense of shareholders.

3. Aggressive Accounting Gimmicks Inflate Earnings and Cash Flows

In Q1 2023, Dayforce reportedly turned a profit for the first time in eleven quarters. The stock duly rallied off its lows as investors mistook this news as evidence that the business had finally turned a corner. Yet our research suggests that this alleged turnaround was merely a mirage created by aggressive accounting gimmicks which, in our opinion, deceived investors regarding the profitability and cash flows of Dayforce's business.

First, we believe that Dayforce inappropriately doubled the time period for amortizing of sales commissions, artificially boosting **pre-tax profits by 60% despite no improvement by the underlying business**. Second, a review of the HCM space reveals that Dayforce aggressively capitalizes significantly more software development costs compared to peers, which we believe inappropriately and artificially inflates both reported profits and operating cash flow.

Our calculations suggest that **these aggressive accounting maneuvers allow Dayforce to artificially inflate its pre-tax profit by 96%,** further obscuring the Company's true profitability from investors. After adjusting for the Company's accounting shenanigans, we estimate that Dayforce remains unprofitable. As such, we believe not only that Dayforce is far less profitable and generates far less operating cash than investors are led to believe, but that Dayforce's chronically unprofitable business does not deserve to trade at a premium valuation compared to its HCM peers.

- **Commission Amortization Schedules Manipulated Far Beyond Actual Term of the Contracts**

One of the Company's major cost centers is the commissions paid to its sales team. Instead of recognizing such costs up front, these commissions are capitalized. In December 2022, Dayforce decided to **double** the length of time over which it amortizes commission costs, which began artificially boosting Dayforce's reported profitability beginning in December 2022.

Previously, Dayforce amortized capitalized commission costs in a straight line over five years. This was already longer than the term of most Company contracts. According to its filings, Dayforce states that customer contracts typically have terms between 3-5 years. We interviewed a former Dayforce employee who stated that most customer contracts were only for three-year terms.

Recurring Revenues

For our Dayforce solutions, we primarily charge monthly recurring fees on a PEPM basis, generally one-month in advance of service, based on the number and type of solutions provided to the customer and the number of employees at the customer. We charge Powerpay customers monthly recurring fees on a per-employee, per-process basis. For our other recurring solutions, we typically charge monthly recurring fees on a per-process basis. The typical recurring customer contract has an initial term between three and five years. Any credits related to service level commitments are recognized as incurred, as service level failures are not anticipated at contract signing. Should a customer cancel the initial contract, an early termination fee may be applicable, and revenue is

Source: Dayforce 2023 10-K

Dayforce was already amortizing commissions beyond the life of most contracts. Yet in December 2022, Dayforce announced that it was stretching the amortization period for capitalized commission costs from five years to **ten years**, claiming that high customer retention rates and longer contracts justified the accounting change.

Deferred Costs

Deferred costs primarily consist of deferred sales commissions. Sales commissions paid based on the annual contract value of a signed customer contract are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions paid based on the annual contract value are deferred and then amortized on a straight-line basis over a period of benefit. As of December 1, 2022, we increased the expected period of benefit of our deferred sales commissions from five years to ten years. This change in accounting estimate and related customer period of benefit is largely attributable to new evidence of longer customer relationships such as increases in the proportion of new customer contracts greater than three years as well as our continued high customer retention rates. The change was made on a prospective basis. The effect of this change reduced amortization expense by $3.2 million for the twelve months ended December 31, 2022. The change in estimate will also impact future periods, with an estimated reduction to amortization expense in the range of $35 million to $37 million for the twelve months ended December 31, 2023.

Source: 2022 Annual Report

According to interviews with former employees, most Dayforce customers sign 3-year contracts. By blowing out the amortization period to 10 years, Dayforce is stretching out its recognition of sales commissions expenses to three times the average contract length, delaying the recognition of costs until future periods. This accounting gimmick creates a significant mismatch between revenue recognition (over the first three years) and commission cost recognition (over ten years), substantially inflating Dayforce's profitability in the early years of each contract.

We see this seemingly indefensible extension of its amortization period as nothing more than a highly aggressive accounting maneuver which inappropriately flatters earnings. The impact on Dayforce's financials is significant. The Company admits by merely stretching out the recognition of commission costs over 10 years, it artificially boosted operating profit by ~$35-37 million in 2023.

By simply manipulating its amortization schedules, the Company was able to inflate its 2023 pre-tax earnings by 60% without any meaningful improvement of its underlying business.

$m	FY23
GAAP Earnings before taxes	96
Less: Impact of amortization schedule management	(36)
Adj. GAAP Earnings before taxes	60
% inflated	***60%***

Source: Company Public Filings

Such aggressive accounting makes Dayforce an outlier. Except for Paycom, no other HCM company stretches its commission cost amortization period as far. This is not a flattering comparison, as Paycom's aggressive accounting practices were already highlighted by Kerrisdale Capital in July 2022. After extending its amortization period from five to ten years, Dayforce is now tied for the longest amortization period among its peers.

Amortization Schedule of Capitalized Commission Costs

Company	Amortization Period
Automatic Data Processing	3-8 years
Workday	5 years
Paychex	8 years
Paylocity	7 years
Paycor	6 years
Paycom	**10 years**
Dayforce	**10 years**

Source: Companies Public Companies

Paycom, another alleged connoisseur of aggressive accounting practices, also currently trades at a discount to its peers. We believe this should ultimately be Dayforce's fate. Aggressive accounting changes are pure financial fiction and do not represent real improvements in the Company's business. Misleading accounting gimmicks should command a discount, not a premium, to share price.

- **Inappropriately Capitalized Software Development Costs to Inflate Earnings**

Dayforce capitalizes an abnormally large proportion of its "software developed or obtained for internal use." We believe that such aggressive capitalization of software development costs not only allows Dayforce to inflate earnings but operating cash flow.

While capitalizing a portion of software development costs is not uncommon among HCM companies, Dayforce reports a significantly higher amount than its peers. In 2023, Dayforce reportedly capitalized $87 million of software costs, representing 44% of its total development costs.

Product development and management expense increased $40.0 million, or 23.5%, for the year ended December 31, 2023, compared to the year ended December 31, 2022. The increase reflects additional personnel costs, including share-based compensation. For the years ended December 31, 2023, and 2022, our investment in software development was $198.5 million and $162.2 million, respectively, consisting of $112.0 million and $92.3 million of research and development expense, and $86.5 million and $69.9 million of capitalized software development, respectively. Please refer to Part II, Item 8, Note 2, "Summary of Significant Accounting Policies," for further discussion of our accounting policy for capitalizing internally developed software costs.

Source: Dayforce 2023 10-K

Dayforce Capitalizes Almost Half of its Software Development Spending

$m	2018	2019	2020	2021	2022	2023
Investment in software development	55	67	78	132	162	199
Research and development expense	30	34	40	81	92	112
Capitalized software development costs	25	33	39	51	70	87
% capitalized	***46%***	***49%***	***49%***	***38%***	***43%***	***44%***

Source: Company Public Filings

Compared to its peer group, Dayforce is again a major outlier. In the last twelve months, we estimate that listed HCM companies capitalized a median of 29% of software development spending.

Capitalized Software Development Costs as a % of Total Research and Development Costs

	2019	2020	2021	2022	2023
ADP*	23%	24%	29%	25%	21%
Workday*	11%	11%	7%	9%	4%
Paycom	29%	33%	31%	31%	33%
Paylocity	31%	29%	29%	25%	29%
Paycor	29%	37%	41%	42%	44%
Median	**29%**	**29%**	**29%**	**25%**	**29%**
Dayforce	**49%**	**49%**	**38%**	**43%**	**44%**

Source: Companies Public Filings[12]

Put simply, we calculate that other HCM peers have expensed a far greater proportion of software development costs than Dayforce. This has the effect of making Dayforce appear more profitable relative to its comps. But in our view, there is no reason to think that Dayforce's business is much different than its HCM peers – rather the difference is that Dayforce is likely far more aggressive in capitalizing software development costs in a way that artificially inflates its reported profitability and its reported cash flows from operations.

Not only do we think that Dayforce capitalizes an inappropriate amount of software development costs, but this aggressive accounting has a major impact on its reported performance. We estimate that, by capitalizing an additional 15% of its software development spending above its peer group average, Dayforce artificially inflated its 2023 adjusted EBITDA by $30 million.

In our view, aggressively capitalizing an additional $30 million in annual software development costs also allows Dayforce to report inflated operating cash flows. **We estimate that almost all of Dayforce's positive operating cash flows comes from either interest income on customer funds or this accounting gimmick**.

[12] ADP and Workday did not disclose the amount of capitalized software costs, so we estimate the ratio by assuming the additions in software related assets are capitalized software costs and assuming that amount and R&D expenses constitute total R&D spending.

$m	2019	2020	2021	2022	2023
Reported total investment in software development	67	78	132	162	199
Peers' Capitalized %	*29%*	*29%*	*29%*	*25%*	*29%*
BOC est. capitalized software development costs	19	23	38	41	57
Reprted capitalized software development costs	33	39	51	70	87
Underreported software development costs	(13)	(16)	(12)	(29)	(30)
Reported adjusted EBITDA	185	159	163	250	410
Underreported software development costs	(13)	(16)	(12)	(29)	(30)
Reported adjusted EBITDA added underreported costs	171	143	150	222	380
Cash Flow from Operating Activities	51	(30)	49	133	220
Less: Underreported software development costs	(13)	(16)	(12)	(29)	(30)
Less: Float revenue	(80)	(52)	(41)	(80)	(169)
Adjusted Cash Flow from Dayforce's Operations	**(43)**	**(98)**	**(5)**	**24**	**21**

Source: Companies Public Filings; BOC Calculation

We estimate the impact of excessive capitalization inflates Dayforce's pre-tax earnings by $11 million in 2023. Added together with the impact of doubling amortization period of sales commissions, we estimate that the Company's accounting gimmicks inflated pre-tax earnings by a staggering 96% in 2023.

$m	FY23
GAAP Earnings before taxes	96
Less: Impact of amortization schedule management	(36)
Less: Impact of underreported software development costs	(11)
Adj. GAAP Earnings before taxes	49
% inflated	***96%***

Source: Dayforce Public Filings, BOC Calculation

We believe that Dayforce is misleading investors by inappropriately capitalizing software development costs and arbitrarily blowing out the amortization period of commission payments on 3-year contracts to 10 years. We do not think it is a coincidence that Dayforce reported positive net income for the first time in 11 quarters following the adoption or acceleration of these accounting gimmicks.

Investors, however, appear to have been fooled, as Dayforce's stock bounced off of its lows following the announcement that Dayforce had finally turned a profit in Q1 2023. In our opinion, this was no turnaround but mere financial alchemy. Instead of making meaningful improvements to their business, we believe that Dayforce's management adopted extremely aggressive accounting in order to create the misleading impression that its troubled business was finally profitable. Don't be fooled.

4. Half a Billion Dollar Error, Adverse Auditor Opinions, Insider Sales, and Executive Turnover

Dayforce is a governance mess and appears to have many of the hallmarks of a Company engaging in accounting gimmickry and manipulation of financial results. For instance, the Company delayed filing its Q3 2023 report because it forgot to report $546 million of customer fund assets and obligations in FY2022, at which time its auditors issued an adverse opinion on the effectiveness of its internal controls. In 2023, Dayforce also reported a slew of management departures, confirming, in our view, that something is amiss. Over the past twelve months, its CRO, CFO, and co-CEO all left the Company. Insiders, who know the Company best, have also sold ~$160 million worth of stock since 2021.

In November 2023, Dayforce disclosed a $546.3 million correction of their customer funds balance to its accounts for FY2022. While the Company describes the error as immaterial, we question how a company of Dayforce's size could undercount customer funds by half a billion dollars, which amounted to 20% of the money market securities on the balance sheet?

Immaterial Correction of Prior Period Error

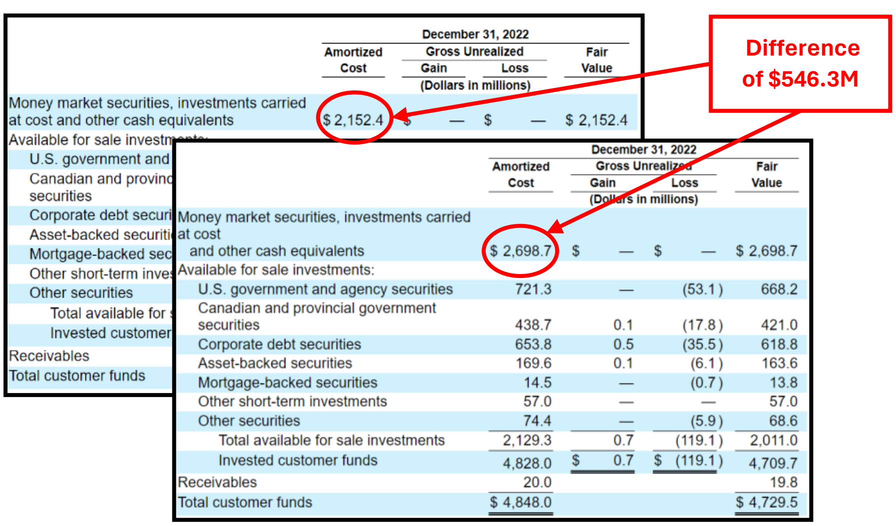
We recently discovered an error in the presentation of one Canadian bank account balance within "customer funds" and "customer funds obligations" and related items on the Company's condensed consolidated balance sheet as of December 31, 2022 and in the Company's net cash provided by financing activities within its condensed consolidated statement of cash flows for the nine months ended September 30, 2022. There was an understatement of customer funds within current assets and a corresponding understatement of customer funds obligations within current liabilities on the Company's condensed consolidated balance sheets. As a result, the Company also erroneously presented certain changes related to customer funds and customer funds obligations on the Company's condensed consolidated statements of cash flows. The line items affected include "customer funds" and "customer funds obligations" on our condensed consolidated balance sheets. The line items affected also include "increase (decrease) in customer funds obligations, net," effect of exchange rate changes on cash, restricted cash, and equivalents," "cash, restricted cash, and equivalents," and "restricted cash and equivalents included in customer funds," and "effect of exchange rate changes on cash, restricted cash, and equivalents" on our condensed consolidated statements of cash flows. The amounts impacted by the correction are summarized as follows:

Condensed Consolidated Balance Sheets
(Selected financial statement line items only)

	December 31, 2022		
	As reported	As restated	Change
	(Dollars in millions)		
Customer funds	$ 4,183.2	$ 4,729.5	$ 546.3
Customer funds obligations	4,298.8	4,845.1	546.3

Source: Dayforce Q3 2023 10-Q

The Company dismissed the error as inconsequential because they also made an error with respect to offsetting customer liabilities and attributed the mistake to a Canadian bank account. To us, these disclosures are deeply concerning because a Company of Dayforce's alleged size and sophistication should not be undercounting half a billion dollars of customer funds.



	December 31, 2022			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(Dollars in millions)			
Money market securities, investments carried at cost and other cash equivalents	$ 2,152.4	$ —	$ —	$ 2,152.4

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(Dollars in millions)			
Money market securities, investments carried at cost and other cash equivalents	$ 2,698.7	$ —	$ —	$ 2,698.7
Available for sale investments:				
U.S. government and agency securities	721.3	—	(53.1)	668.2
Canadian and provincial government securities	438.7	0.1	(17.8)	421.0
Corporate debt securities	653.8	0.5	(35.5)	618.8
Asset-backed securities	169.6	0.1	(6.1)	163.6
Mortgage-backed securities	14.5	—	(0.7)	13.8
Other short-term investments	57.0	—	—	57.0
Other securities	74.4	—	(5.9)	68.6
Total available for sale investments	2,129.3	0.7	(119.1)	2,011.0
Invested customer funds	4,828.0	$ 0.7	$ (119.1)	4,709.7
Receivables	20.0			19.8
Total customer funds	$ 4,848.0			$ 4,729.5

Source: (Left) Dayforce FY '22 10-K, (Right) Dayforce Q3 '23 10-Q

It is hard to imagine how a $10 billion market cap company could lose track of customer funds or fail to reconcile its banks accounts, and we question why it apparently took the Company more than half a year to discover this mistake.

As a result, the Company now warns investors about a material weakness in internal controls over financial reporting regarding its cash balance.

As discussed in our Annual Report on Form 10-K/A, we identified a material weakness in our internal control over financial reporting as we have determined that our control was not operating effectively to assess the proper presentation of cash and cash equivalents for our Canada customer funds for financial reporting purposes, including the corresponding customer funds and customer funds obligations and related statements of cash flows presentation as of December 31, 2022, which continues to exist as of September 30, 2023. This material weakness was the result of the control operator not appropriately detecting and correcting the error, as a result of insufficient training.

Source: Dayforce 10-Q Q3 2023

Yet because of this understatement of half a billion dollars, the Company revealed another material weakness regarding its professional service revenue. This led to an amended 10-K in which its auditor withdrew its previous clean opinion and issued an adverse opinion on the Company's internal controls, despite the fact that the previous year's 10-k was already complete and filed with the SEC.

A $10 billion market cap company with an internal control warning is highly unusual. According to Hudson Labs, less than 4% of large cap companies reported a material weakness in internal controls. Based on our review of the filings, only 10 of the S&P 500 companies reported an adverse opinion on internal controls, making Dayforce an unusual outlier.[13]

For a Company promising investors a bright future, insiders have also been dumping stock. Led by the CEO, **Dayforce insiders have sold over 1.7 million shares of the Company since 2021 representing a value of ~$160 million**.

	# of shares sold ('000)	Proceeds ($M)
Ossip, David D. (Chairman & CEO)	1,250	129.5
Turner, Leagh Erin (Former Co-CEO & Director)	164	13.5
Armstrong, Christopher R. (Executive VP & COO)	181	11.9
Korngiebel, Joseph B. (Executive VP and Chief Product & Technology Officer)	60	4.5
Holdridge, Stephen H. (President of Customer & Revenue Operations)	31	2.2
McDonald, William E. (Executive VP, General Counsel & Corporate Secretary)	24	2.1
Heuland, Noemie Clemence (Former Executive VP & CFO)	26	1.8
Total	**1,736**	**165.5**

Source: CapIQ

Equally concerning is the number of executive resignations, especially related to key financial supervisory positions. Led by the resignations of the Co-CEO in November 2023, and the CFO in July 2023, Dayforce seems to be experiencing executive defections in key positions.

Name	Former Position	Start	End
Leagh Erin Turner	Co-CEO	Feb-22	Nov-23
	Board of Directors	Feb-22	Nov-23
Noemie C. Heuland	CFO	Oct-20	Dec-23
Brendan Reid	Chief Marketing Officer	Jan-19	Jun-23
Warren Perlman	Chief Technology Officer, Global	Nov-22	May-23
Rocky Subramanian	Executive Vice President and Chief Revenue Officer	Apr-21	Mar-23

Source: Cap IQ, LinkedIn, Dayforce Corporate Filings

Unusual and frequent executive turnover at the highest levels is consistent with our investment thesis that Dayforce has become increasingly aggressive in engaging in accounting gimmicks to inflate reported profitability and financial performance. In our experience, a wave of executive departures in key accounting or finance roles often precedes revelations of accounting shenanigans and restatements.

[13] From March 29, 2023 to March 29, 2024.

5. Stock on the Edge of the Precipice

We believe that Dayforce engages in aggressive accounting maneuvers to inappropriately pull forward revenues, inflate profits, and underreport costs. We also believe that it promotes bogus profitability metrics in order to mislead investors, propping up its share price and enriching management whose absurdly rich performance packages either directly benefit from these accounting gimmicks or are tied explicitly to these misleading metrics.

In our view, management's greed is unparalleled among public companies we have examined in recent past. Despite trying to grab themselves a compensation package so egregious it was rejected by shareholders; in 2023, management slipped float revenue back into its reward plan. We believe this allows management to enrich themselves with undeserving pay packages even though Dayforce has reported mostly net losses since its IPO.

Compared to HCM peers, despite worst-in-class GAAP gross margins, Dayforce trades at an inexplicable premium. We believe that this premium valuation is entirely unjustified and is the result of Dayforce's financial alchemy and accounting gimmicks which have created a lattice structure of misperceptions about its business.

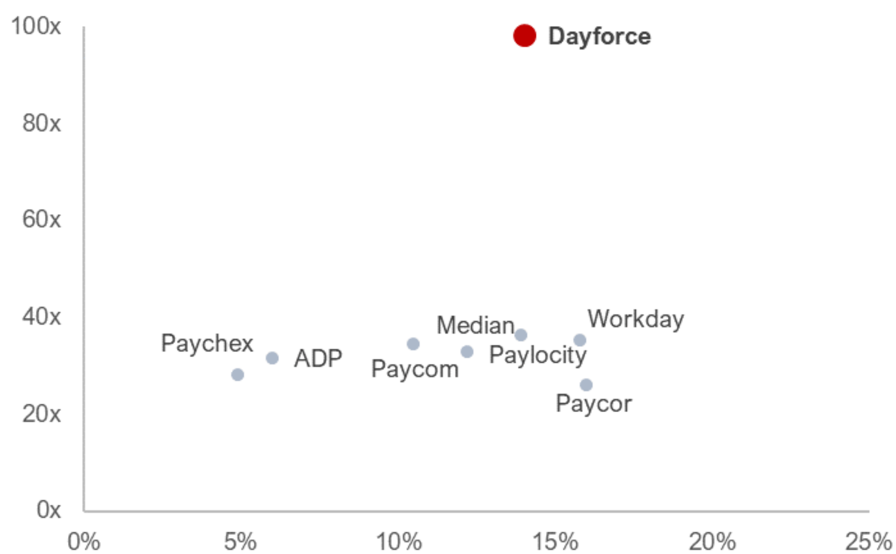
Yet the industry realities are undeniable, which we think puts Dayforce's stock teetering on the edge of the proverbial precipice. If Dayforce's stock merely corrected to industry median multiples, we would expect a 25%+ decline in the Company's share price on relative valuation alone.

But the downside is so much greater, because we believe that investors have been misled about the Company's performance and financials by misleading profitability metrics and accounting gimmicks. Once we adjust for its financial alchemy, a true apples-to-apples comparison implies **51-60% downside in Dayforce's share price**.

- **Dayforce Trades at an Absurd Premium to its HCM Competitors**

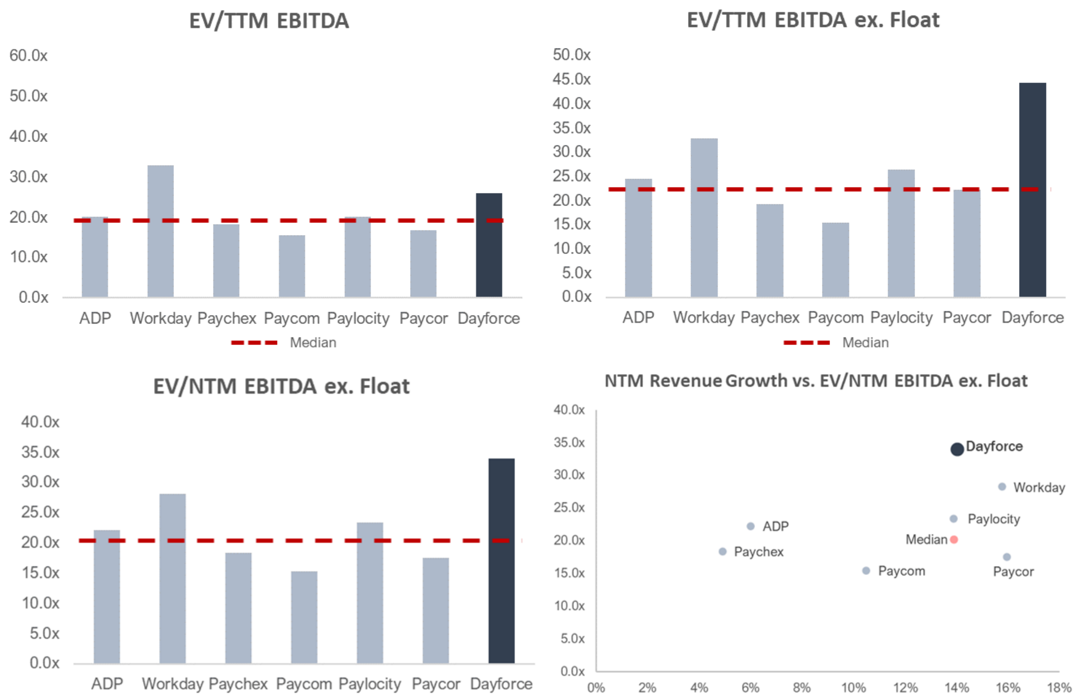
Comparing future growth prospects and current P/FCF multiples, Dayforce trades at an insanely expensive relative valuation despite the Company's shady accounting.

Projected NTM Revenue Growth VS. Price/ TTM FCF



Source: CapIQ

By a slew of other metrics, most notably on multiples of EBITDA, Dayforce trades at a stark premium to its HCM peers, despite industry worst GAAP gross margins and a business that cannot consistently generates GAAP profits.



Source: CapIQ, Companies Public Filings, Sell-Side Reports, BOC Adjustments

Without any adjustments, on **relative valuation alone, we would expect at least a 25% downside** in the stock on the basis that Dayforce should not be immune to the same forces dragging down other HCM companies.

Company	Market Cap	TTM Gross Margin	TTM EBITDA Margin	EV/TTM EBITDA	EV/NTM EBITDA	Price/TTM FCF
ADP	100,697	45%	27%	20.1x	18.1x	31.5x
Workday	70,971	76%	28%	32.9x	28.2x	35.4x
Paychex	43,289	72%	45%	18.3x	17.2x	28.2x
Paycom	11,363	84%	42%	15.5x	15.4x	34.4x
Paylocity	9,372	69%	35%	20.2x	18.2x	36.3x
Paycor	3,205	66%	31%	16.9x	14.0x	26.2x
Median		**70%**	**33%**	**19.2x**	**17.7x**	**33.0x**
Dayforce	**10,042**	**43%**	**27%**	**26.1x**	**21.9x**	**98.0x**
Downside				**-27%**	**-19%**	**-66%**

Source: CapIQ

But this tells only part of the story. Dayforce's premium valuation is even more absurd when we remove the impact of float revenue, which has little to do with the underlying SaaS business. As discussed in this report, Dayforce is unusually reliant on float revenue as it represents 41% of its LTM EBITDA, verses a median of 18% for its peers.

Adjusting for float revenue, Dayforce's current valuation appears even more ludicrous, with the Company trading **TEV/ LTM Float Adjusted EBITDA multiple that is ~2x the industry average**.

Company	EV/LTM EBITDA ex. Float Rev	EV/LTM EBIT ex. Float Rev	EBITDA ex. Float Rev	EV/NTM EBIT ex. Float Rev
ADP	24.5x	27.6x	22.2x	25.1x
Workday	32.9x	38.2x	28.2x	32.1x
Paychex	19.3x	21.0x	18.3x	19.7x
Paycom	15.5x	18.8x	15.4x	19.1x
Paylocity	26.4x	33.0x	23.4x	28.6x
Paycor	22.2x	64.8x	17.5x	45.5x
Median	**23.4x**	**30.3x**	**20.2x**	**26.8x**
Dayforce	**44.4x**	**62.6x**	**34.0x**	**50.8x**

Source: CapIQ, Sell-Side Reports, BOC Adjustments[14]

Yet this is only the beginning of the adjustments we think are necessary to understand Dayforce's valuation in the context of how the market properly values HCM companies. We believe that a proper apples-to-apples comparison to other HCM companies requires a number of adjustments to remove the impact of Dayforce's financial alchemy.

- **Apples-to-Apples Comparison Implies over 50%+ Downside vs. Peers**

First, as previously discussed, we estimate that Dayforce is inappropriately pulling forward $104 million of professional services revenue. We think Dayforce manipulates the recognition of stand-alone selling prices, an accounting construct by which it pulls increasing amounts of professional services forward for financial reporting purposes.

This explains why, despite a pivot towards outsourcing to systems integrators, Dayforce reports almost double the amount of professional services revenue (as a percentage of total ex float revenue) versus industry leading peers like Workday. We believe it is necessary to adjust the Company's financials to normalize professional service revenues towards an appropriate level. Accordingly, if we simply benchmark the amount of its professional service revenue to Workday's, we believe that investors should remove $104 million of operating profit from Dayforce's income statement.

Second, we believe it is appropriate to reverse Dayforce's absurd accounting change blowing out the useful life of commission payments from 5 to 10 years, which creates a mismatch not only between revenue and cost recognition but is out of line with industry standards. Normalizing the amortization period to five years is appropriate for both an apples-to-apples comparison but also to properly match the Company's revenues with its expenses.

Lastly, as discussed above, we believe that Dayforce is far too aggressive in capitalizing software costs. We believe that this inappropriately inflates both earnings and operating cash flows. We therefore adjust Dayforce's capitalization of software costs to industry standard.

On an apples-to-apples basis, after adjustment, we estimate that **Dayforce's effectively trades at an EV/EBITDA multiple of 38.8x and an EV/ EBIT multiple of 56.9x**. Needless to say, these multiples are absurd for an HCM company. We believe investors will eventually see through the Company's accounting façade. As such, we believe that post adjustments to Dayforce's reported figures, there is a **51-60% downside in the Company's equity**.

$m	
TEV	10,715
FY23 EBITDA	410
Less: est. pull forward revenue	(104)
Less: est. capitalized software cost adjustment	(30)
BOC Adjusted FY23 EBITDA	276
TEV/ BOC Adjusted FY23 EBITDA	**38.8x**
Industry Median EV/LTM EBITDA	19.2x
Implied Downside	**-51%**

$m	
TEV	10,715
FY23 EBIT	340
Less: est. pull forward revenue	(104)
Less: amortization schedule management	(36)
Less: est. capitalized software cost adjustment	(11)
BOC Adjusted FY23 EBIT	188
TEV/ BOC Adjusted FY23 EBIT	**56.9x**
Industry Median EV/LTM EBIT	23.0x
Implied Downside	**-60%**

Source: CapIQ, BOC Adjustments

[14] Paycom did not disclose its float revenue, so its multiples include float revenue.

If we apply the same adjustments to Dayforce's FY24 performance forecast, it would imply a downside of 42-55% when compared on an apples-to-apples forward EV/EBITDA as peers.

$m	
TEV	10,715
FY24E EBITDA	489
Less: est. pull forward revenue	(104)
Less: est. capitalized software cost adjustment	(30)
BOC Adjusted FY24E EBITDA	355
TEV/ BOC Adjusted FY24E EBITDA	**30.2x**
Industry Median EV/NTM EBITDA	17.7x
Implied Downside	**-42%**

$m	
TEV	10,715
FY24E EBIT	385
Less: est. pull forward revenue	(104)
Less: amortization schedule management	(36)
Less: est. capitalized software cost adjustment	(11)
BOC Adjusted FY24E EBIT	234
TEV/ BOC Adjusted FY24E EBIT	**45.8x**
Industry Median EV/NTM EBIT	20.6x
Implied Downside	**-55%**

Source: CapIQ, BOC Adjustments

We think investors should ultimately see through Dayforce's financial alchemy and that the Company's share price should trade at the discount to other HCM peers it so richly deserves.

DISCLAIMER

We are short sellers. We are biased. So are long investors. So is Dayforce. So are the banks that raised money for the Company. If you are invested (either long or short) in Dayforce, so are you. Just because we are biased does not mean that we are wrong. We, like everyone else, are entitled to our opinions and to the right to express such opinions in a public forum. We believe that the publication of our opinions about the public companies we research is in the public interest.

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