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**.

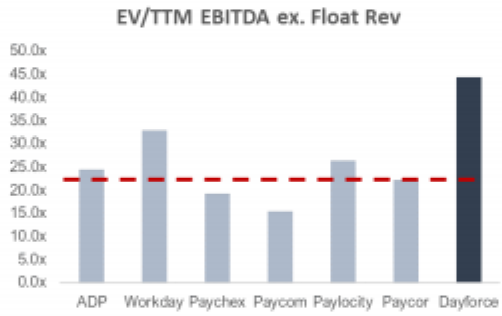
Management has significant incentive to manipulate this critical non-GAAP metric. Frequently the subject of stinging criticism in the media for outrageous pay packages and excessive greed, management recently tied their own compensation packages to these nonsense non-GAAP performance indicators. In 2021, 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.

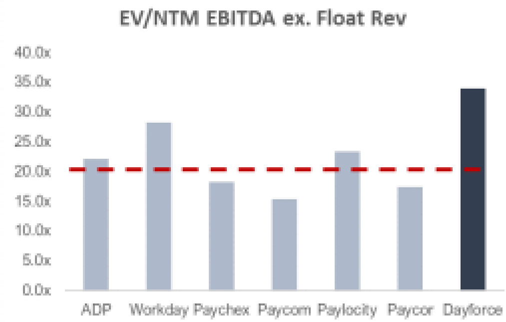
3. **Aggressive Accounting Gimmicks Inflate Earnings and Cash Flows**. Shares of Dayforce rallied after its Q1 2023 earnings call, when the Company announced its first positive profit in eleven quarters. Yet our research suggests that this alleged turnaround was largely a mirage created by aggressive 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 toten years, eventhough 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 providerHudson Labsstates 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 atan inexplicable premium. We believe that this premium valuation is entirely unjustified and is the result of financial alchemy and accounting gimmicks which have created alattice 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
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
Industry Median EV/LTM EBIT	23.0x
Implied Downside	**-60%**

Source: CapIQ, BOC Adjustments[1]

If we apply th[illegible] an[illegible]ian EV/ NTM EBIT andEBITDA multiple as its peers, an apples-to-apples comparison would imply up to a 55% downside toDayforce'sstock.

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'speers 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 apreviously 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	1,166 199	1,345 216
Total	674	744	790	983		
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**.

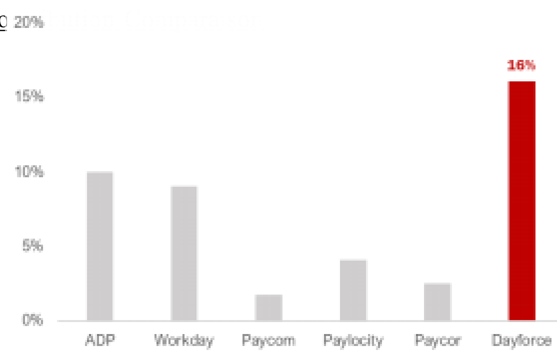
- **Dayforce's Financial Statements are an Inexplicable Outlier Amid Pivot to Systems Integrators**

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 makeup 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 Co

	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%		2.9%		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.

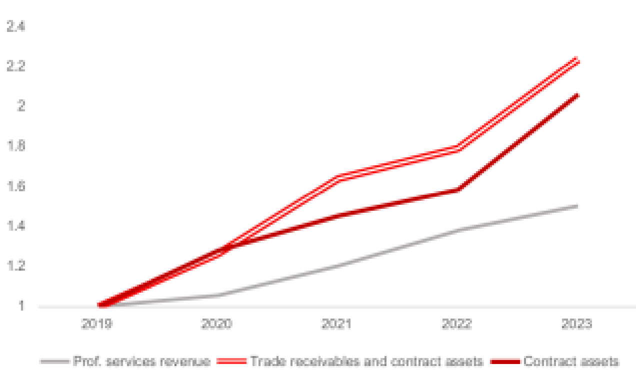
However, Dayforce has reported an ever-increasing balance of unbilled revenue in the form of contract assets, which have doubled from $43 million in FY 2019, to $89 million in 2023. Combined with traditional accounts receivables, Dayforce's balances suggest that the Company is increasingly recognizing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

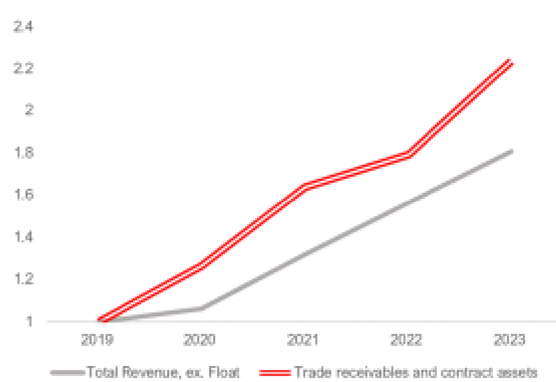
	2019	2020	2021	2022	2023	%Change
Reported Revenue, ex. Float	744	790	983	1,166	1,345	81%
Professional services revenue	144	152	174	199	216	50%
Trade receivables, net and contract assets	113	143	185	202	253	124%
Contract assets	43	55	63	69	89	106%

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 results of its operations and its cash flows for each of the years in the three-year period ended December 31, 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 awindfall 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 DressUp 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

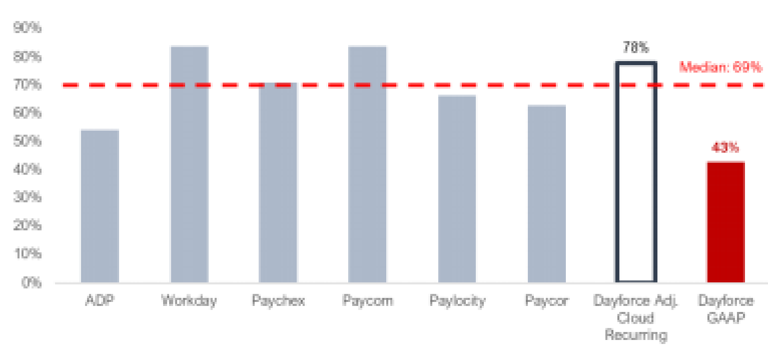
Chairman & Co-CEO

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.

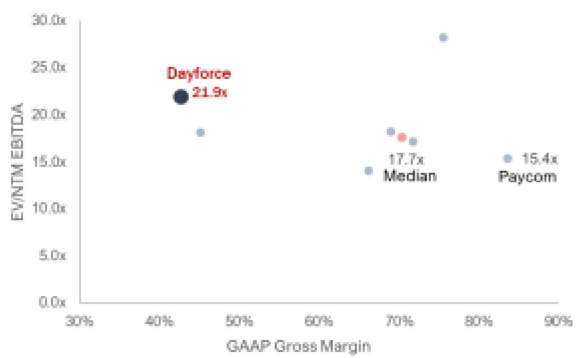
[8]All of Dayforce's peers, except Paycom, exclude float revenue from the calculation of recurring gross margin or recurring revenue. For ADP, we adjusted its PEO zero-margin benefits pass-throughs, as this was not recurring revenue. ADP's margin also includes implementation revenue, so we believe its 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