Paychex, Inc (PAYX)

Updated June 15th, 2018 by Nate Parsh

Key Metrics

Current Price:	$69	**5 Year CAGR Estimate:**	3.4%	**Quality Percentile:**	N/A
Fair Value Price:	$58	**5 Year Growth Estimate:**	3.7%	**Momentum Percentile:**	N/A
% Fair Value:	119%	**5 Year Valuation Multiple Estimate:**	-3.5%	**Total Return Percentile:**	N/A
Dividend Yield:	3.2%	**5 Year Price Target**	$69	**Valuation Percentile:**	N/A

Overview & Current Events

Paychex, Inc provides computerized payroll accounting, benefits and human resource services to businesses that employ between 10 and 200 employees. Paychex provides services to more than 600,000 small and medium-sized businesses, primarily in the U.S. The company was incorporated in 1979. Paychex has a market cap of $25 billion and generated $3.2 billion in sales in 2017.

On March 26th, Paychex announced 3rd quarter of fiscal 2018 earnings. The company earned $0.63 per share, in line with what analysts were expecting. EPS grew 12.7% from the previous year's quarter. Paychex generated $866.5 million in sales, a 9% increase year over year and a beat of estimates by $12 million. Payroll services grew 2% to $455 million. Human Resource Services saw sales grow 17% to more than $393 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.56	$1.48	$1.32	$1.42	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	***$2.55***	***$3.06***
DPS	$1.20	$1.24	$1.24	$1.24	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	***$2.18***	***$2.61***

Paychex saw a slight decline in earnings during the last recession. Considering that the company's revenue largely depends on the number of people on payrolls, Paychex did an admirable job suffering just a slight decline in EPS as unemployment reached high levels. As long as unemployment remains very low, Paychex should see earnings continue to grow. If unemployment does increase, it is possible that the company could experience just a slight reduction in earnings based on how well the company navigated the last recession. Paychex grew earnings at a rate of 3.7% per year over the past decade. We expect that the company can continue to see this growth rate through 2023.

One area of growth that should be of interest to shareholders is Paychex's recent purchase of Lessor Group, a payroll and human resources provider based in Denmark. While Paychex does have operations in Germany, this acquisition should allow the company to spread throughout Northern Europe. The company has done well integrating acquisitions into its operations. For example, Paychex's recent acquisition of HR Outsourcing Holdings in August 2017 added 3% to total revenue in the most recent quarter.

Paychex has increased its dividend for the past 8 years, with an average raise of 8.3% annually over the past 5 years. On April 27th, the company gave shareholders a 6% dividend increase. With a high dividend payout, we feel that Paychex will be able to grow its dividend in line with earnings.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	24.6	19.2	22.2	20.7	19.6	21.4	24.1	24.8	24	26.2	***27.1***	***22.7***
Avg. Yld.	3.1%	4.4%	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	***3.2%***	***3.8%***

Paychex's stock currently trades with a price to earnings multiple of 27.1. This has shares trading at a premium to its 10-year average P/E of 22.7. If shares were to revert to their historical average, the stock would experience multiple contraction of 3.5% per year over the next 5 years.

Paychex has offered solid dividend yield for much of the past decade. With a stretched valuation, shareholders best bet for returns could be from the dividend alone.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Int. Cov.	---	---	---	---	---	---	---	---	---	---	**---**	**---**
Payout	76.9%	83.8%	93.9%	87.3%	84.1%	84%	81.9%	82.2%	80.4%	81.8%	***85.5%***	***85.5%***
Std. Dev.	30.6%	30.7%	18.6%	21%	12.2%	10.8%	13.2%	15.4%	21%	16.2%	***16.8 %***	***19%***

While shares of Paychex weren't immune to lower earnings numbers during the last recession, the company held up pretty well given the circumstances. Paychex has no long term debt, so the company could always tap debt markets to fund an acquisition if need be. One area of concern is Paychex's dividend payout ratio. The average payout ratio over the last decade has been around 84%. This doesn't leave much room for dividend increases if earnings suffer a decline.

Final Thoughts & Recommendation

We feel that Paychex shares offer a total return of 3.4% per year for the next 5 years. This return is calculated from earnings growth (3.7%), dividends (3.2%) and multiple reversion (3.5%). With the U.S. economy on solid footing, many small and medium sized businesses have added to their payrolls in recent years. This has helped Paychex grow earnings and driven the price to earnings multiple to a level not seen in the last 10 years. Because of this P/E expansion, we feel much of the possible growth has been taken out of the stock. On the plus side, Paychex offers a better total return than fellow payroll servicer Automatic Data Processing (ADP) based on the acceleration in ADP's share price. Investors purchasing Paychex now are likely expecting the P/E to maintain its current level or continue to expand. Erroring on the side of caution, we don't feel that this is likely to occur.

Total Return Breakdown by Year