Retirement Suitability Score

C

Reasonably Suitable

Paychex, Inc (PAYX)

Updated October 2nd, 2018 by Nate Parsh

Key Metrics

Current Price:	$75	**5 Year CAGR Estimate:**	3.8%	**Volatility Percentile:**	30.3%
Fair Value Price:	$65	**5 Year Growth Estimate:**	3.7%	**Momentum Percentile:**	82.8%
% Fair Value:	115%	**5 Year Valuation Multiple Estimate:**	-2.9%	**Valuation Percentile:**	36.8%
Dividend Yield:	3.0%	**5 Year Price Target**	$78	**Total Return Percentile:**	21.7%

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 $27 billion and generated $3.4 billion in sales in fiscal year 2018.

Paychex reported first quarter earnings for fiscal year 2019 on October 2nd. The company earned $0.67 per share, $0.02 above analysts' estimates. EPS grew 8.1% from the previous year's quarter. Paychex generated $862.8 million in sales, an 8.8% increase year over year. This beat estimates by $12 million.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$1.48	$1.32	$1.42	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	***$2.85***	***$3.42***
DPS	$1.24	$1.24	$1.24	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	***$2.18***	***$2.61***
Shares	361M	361M	361M	362M	365M	363M	361M	360M	359M	359M	***359M***	***359M***

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.

In the second quarter, Payroll services grew 2% to $455 million. Management Solutions saw sales grow 3% to $688 million while PEO & Insurance Services climbed 39% to $158 million. Paychex's acquisition of HR Outsourcing in August of 2017 continues to drive growth for the company, adding almost 19% to PEO & Insurance Services revenue. The company expects this acquisition to add low to mid double digit sales growth for the remainder of fiscal year 2019. The average analysts' estimate for fiscal 2019 is $2.85 per share. If achieved, this would represent 16% growth from fiscal 2018.

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.

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 12% 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Avg. P/E	19.2	22.2	20.7	19.6	21.4	24.1	24.8	24	26.2	25.1	***26.3***	***22.7***
Avg. Yld.	4.4%	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	***3.0%***	***3.3%***

Disclosure: This analyst has a long position in the security discussed in this research report

Shares of Paychex have increased $6, or 8.7%, since our June 15th update. Based on expected earnings per share for the year, the stock has a P/E ratio of 26.3. This is 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 2.9% annually 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	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Int. Cov.	---	---	---	---	---	---	---	---	---	---	*---*	*---*
Payout	83.8%	93.9%	87.3%	84.1%	84%	81.9%	82.2%	80.4%	81.8%	81.8%	***76.5%***	***76.3%***
Std. Dev.	30.7%	18.6%	21%	12.2%	10.8%	13.2%	15.4%	21%	16.2%	16.2%	***16.5 %***	***17.5%***

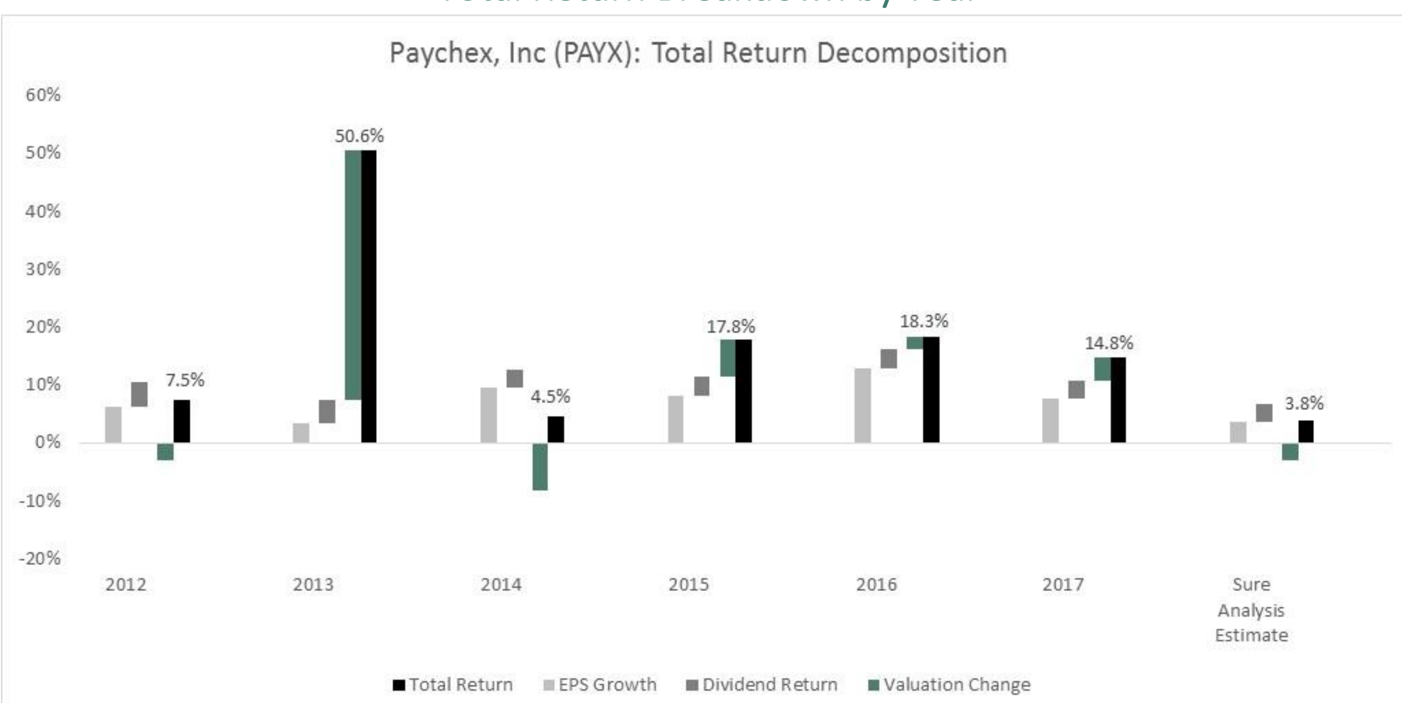
While shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances. Paychex has no long term debt, so the company could always tap debt markets to fund an acquisition if need be. One area of concern is Paychex's dividend payout ratio. The average payout ratio over the last decade has been around 84%, though this ratio is now in the mid 70% range due to higher EPS forecasts. This still doesn't leave much room for dividend increases if earnings suffer a decline.

Final Thoughts & Recommendation

We estimate that Paychex can offer total annual returns of 3.8% through 2024, up from 3.4% previously. This return is calculated from earnings growth (3.7%), dividends (3.0%) and multiple reversion (2.9%). With a low unemployment rate, Paychex should continue to see its sales and earnings increase. Additionally, recent acquisitions have led to strong growth rates. The market has responded, lifting shares by 10.5% this year and 23.6% since the beginning of 2017. We have increased our 2024 target price $9 to $78 due to higher than expected forecast for earnings per share for fiscal year 2019. Even so, Paychex's stock is trading close to our target price. We suggest wait until the stock is trading more in line with its fair value prior to purchasing shares of Paychex.

For retirees, Paychex earns a C rating for Retirement suitability. It's high dividend payout ratio (~76% in 2018) prevents it from ranking higher.

Total Return Breakdown by Year



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