Paychex, Inc (PAYX)

Updated March 28th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	0.2%	**Volatility Percentile:**	29.2%
Fair Value Price:	$57	**5 Year Growth Estimate:**	3.7%	**Momentum Percentile:**	91.7%
% Fair Value:	139%	**5 Year Valuation Multiple Estimate:**	-6.3%	**Growth Percentile:**	21.5%
Dividend Yield:	2.8%	**5 Year Price Target**	$68	**Valuation Percentile:**	8.2%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	4.8%

Overview & Current Events

Paychex, Inc, which was incorporated in 1979, 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 operates two segments: Management Solutions, which provides employers with payroll and retirement resources, and PEO and Insurance, which offers outsourced human resource services and insurance. Paychex has a current market capitalization of $28.5 billion and generated $3.4 billion in sales in fiscal 2018.

Paychex completed its $1.2 billion purchase of Oasis Outsourcing Acquisition Corp on December 21st, 2018. Oasis was the largest privately held professional employer organization in the U.S., serving more than 8,400 clients and 1.4 million employees.

Paychex reported financial results for the third quarter of fiscal 2019 on March 27th. Earnings-per-share grew 41% to $0.89 and revenue improved 24% to $1.07 billion. Revenues for the Management Solutions segment increased 4% to $802 million due to growth in the company's client bases. This segment also had higher revenues per check because of price increases. As with previous quarters, revenue from retirement services was up due to higher asset values. The PEO and Insurance Services segment grew 65% to $246 million. The company's acquisition of Oasis was the primary contributor to growth for this segment. Excluding Oasis, PEO and Insurance Services produced a 17% increase in revenue due to growth in clients. Insurance revenue was higher on an increase in the number of health and benefit applicants. Interest on funds held for clients was improved 27% to $23 million and was due to higher average interest rates.

Paychex maintains its expectation for 11% to 12% earnings-per-share growth and 6% to 7% revenue growth in fiscal 2019. The company's expected tax rate for fiscal 2019 is 24%, well below its usual mid-30% tax rate prior to tax reform passed at the end of 2017.

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	***$2.24***	***$2.69***
Shares	361	361	361	362	365	363	361	360	359	359	***359***	***359***

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 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 2024.

Paychex has increased its dividend for the past 8 years, with an average raise of 7.5% annually over the past 5 years. On April 27th, 2018, the company increased its dividend by 12%. With a high dividend payout, we feel that Paychex will be able to grow its dividend in line with earnings.

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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	***27.7***	***20***
Avg. Yld.	4.4%	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	***2.8%***	***4.0%***

Shares of Paychex have increased $14, or 21.5%, since our December 19th update. Based on expected earnings-per-share for the year, the stock has a P/E ratio of 27.7, up from 22.8 previously. For context, shares of Paychex have an average P/E of 22.7 over the last ten years. We have a target P/E of 20 due to the company's low growth rate. If shares were to revert to this target, the stock would experience multiple reversion of -6.3% per year through 2024.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	84%	94%	87%	84%	84%	82%	82%	80%	82%	82%	***77%***	***79%***

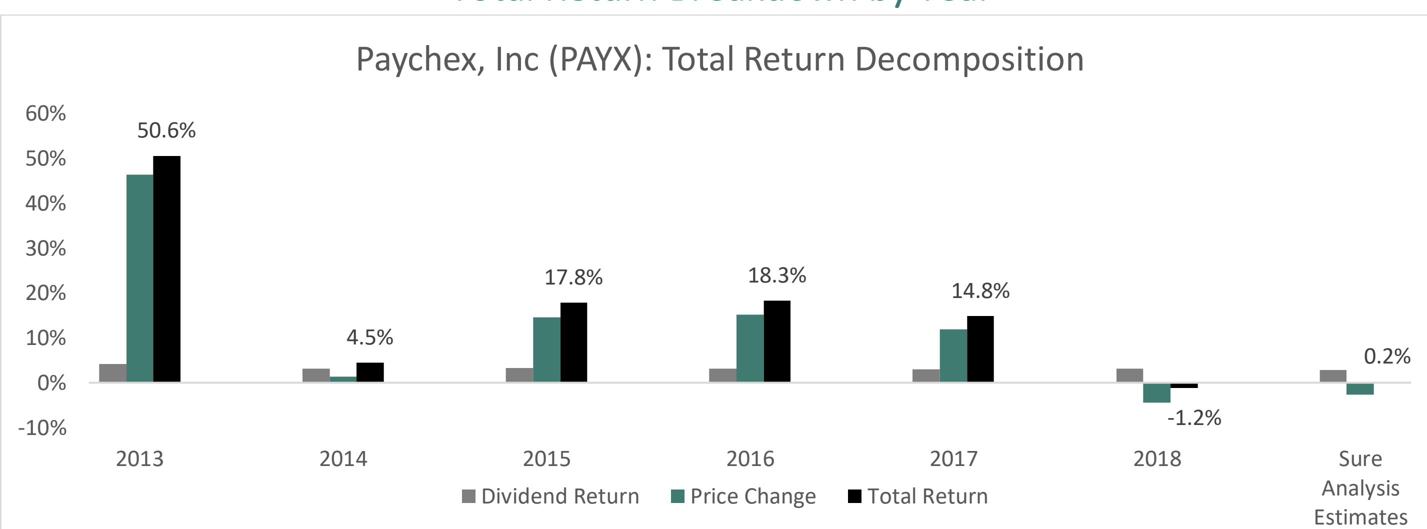
Shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances. Paychex has no long-term debt, so the company could always tap debt markets to fund an acquisition if need be. One area of concern is Paychex's 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 earnings forecasts. This still doesn't leave much room for dividend increases if earnings were to suffer a decline.

Paychex's primary competitive advantage is that it is a leading provider of computerized payroll, account, benefits and human resource services for small and medium sized companies. This gives the company size and scale that competitors are unlikely to match. Another advantage is that Paychex has very little debt on its balance sheet. This allows the company to access debt markets to fund acquisitions, as seen with Paychex's purchase of Oasis.

Final Thoughts & Recommendation

After accounting for third quarter financial results and the recent share price increase, we now estimate that Paychex can offer a total annual return of just 0.2% through 2024, down from 4.2% previously. This return is based on earnings growth (3.7%), dividends (2.8%) and multiple compression (6.3%). The increase in share price since our previous report has removed much of our forecasted potential return. We like the company's leadership in its industry, but Paychex earns a sell recommendation from Sure Dividend at this time due to low expected total returns.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	2007	2001	2084	2230	2326	2519	2740	2952	3151	3381
Gross Profit	1327	1347	1433	1560	1655	1786	1932	2095	2232	2363
Gross Margin	66.1%	67.3%	68.7%	69.9%	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%
SG&A Exp.	597	622	646	706	750	804	878	948	992	1076
D&A Exp.	86	87	89	98	98	105	107	115	127	138
Operating Profit	730	725	786	854	905	983	1054	1147	1240	1288
Operating Margin	36.4%	36.2%	37.7%	38.3%	38.9%	39.0%	38.5%	38.8%	39.3%	38.1%
Net Profit	534	477	515	548	569	628	675	757	817	934
Net Margin	26.6%	23.8%	24.7%	24.6%	24.5%	24.9%	24.6%	25.6%	25.9%	27.6%
Free Cash Flow	608	550	615	617	577	797	792	921	866	1122
Income Tax	279	252	277	312	342	361	385	394	428	362

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	5127	5226	5394	6480	6164	6370	6468	6441	6834	7464
Cash & Equivalents	473	284	119	109	107	153	170	132	185	358
Accounts Receivable	178	187	161	142	133	149	177	409	508	531
Goodwill & Int. Ass.	510	483	591	573	579	581	594	727	715	955
Total Liabilities	3786	3824	3898	4875	4390	4593	4682	4529	4878	5439
Accounts Payable	37	37	45	70	43	49	52	57	57	75
Long-Term Debt	0	0	0	0	0	0	0	0	0	0
Shareholder's Equity	1341	1402	1496	1605	1774	1777	1786	1912	1955	2025
D/E Ratio	0	0	0	0	0	0	0	0	0	0

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	10.2%	9.2%	9.7%	9.2%	9.0%	10.0%	10.5%	11.7%	12.3%	13.1%
Return on Equity	42.0%	34.8%	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.3%	46.9%
ROIC	42.0%	34.8%	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.3%	46.9%
Shares Out.	361	361	361	362	365	363	361	360	359	359
Revenue/Share	5.56	5.53	5.75	6.14	6.38	6.88	7.51	8.14	8.69	9.35
FCF/Share	1.68	1.52	1.70	1.70	1.58	2.18	2.17	2.54	2.39	3.10

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.