Paychex, Inc (PAYX)

Updated June 26th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$84	**5 Year CAGR Estimate:**	2.9%	**Volatility Percentile:**	29.4%
Fair Value Price:	$65	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	82.1%
% Fair Value:	129%	**5 Year Valuation Multiple Estimate:**	-5.1%	**Growth Percentile:**	35.6%
Dividend Yield:	3.0%	**5 Year Price Target**	$83	**Valuation Percentile:**	20.5%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	16.1%

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 almost $4 billion in sales in fiscal 2019. Paychex completed its $1.2 billion purchase of Oasis Outsourcing Acquisition Corp on December 21st, 2018. Oasis serves more than 8,400 clients and 1.4 million employees.

Paychex reported financial results for the fourth quarter and fiscal year 2019 on June 26th. Adjusted earnings-per-share grew 3.3% to $0.63 for the quarter, though this was $0.01 below estimates. Revenue increased 16% to $980 million, which was slightly above what analysts were expecting. For fiscal 2019, Paychex earned $2.84 per share, $0.01 below our estimate while revenue grew 12% to $3.8 billion.

Revenue for the Management Solutions segment totaled $695 million for the quarter and $2.9 billion for the year, a 4% increase for both time periods. Growth was driven by an increase in client base, as well as higher revenue per check. Revenue from Retirement Services increased due to larger asset values of participants' 401(k) funds. PEO and Insurances services grew 67% to $263 million in the quarter and 48% to $822 million for fiscal 2019. Excluding Paychex's acquisition of Oasis, this division had quarterly growth of 10% and fiscal year growth of 19%. An increase in clients and client worksite employees was principally responsible for results. Interest on funds held for clients improved 25% and 27% for the fourth quarter and fiscal 2019, respectively. Paychex expects to earnings-per-share in a range of $3.06 to $3.10 for fiscal 2020. At the midpoint, this would be an increase of 8.5% from fiscal 2019. Guidance was below what the market had expected. The company sees revenue growing 10% to 11% to $4.18 billion to $4.22 billion.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.32	$1.42	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	***$3.08***	***$3.93***
DPS	$1.24	$1.24	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	***$2.48***	***$3.17***
Shares	361	361	362	365	363	361	360	359	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 earnings-per-share 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. Due to contributions from the Oasis acquisition, we now expect the company to grow earnings-per-share at a rate of 5% through fiscal 2025.

Paychex has increased its dividend for the past 9 years, with an average raise of 7.5% annually over the past 5 years. On May 3rd, 2019, the company increased its dividend by 10.7%. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Avg. P/E	22.2	20.7	19.6	21.4	24.1	24.8	24.0	26.2	25.1	29.6	***27.3***	***21.0***
Avg. Yld.	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	***3.0%***	***3.8%***

Shares of Paychex have increased $5, or 6.3%, since our March 28th update. Based on expected earnings-per-share for the current fiscal year, the stock has a P/E ratio of 27.3. For context, shares of Paychex have an average P/E of 22.7 over the last ten years. We have increased our target P/E to 21 from 20 due to the Oasis acquisition. If shares were to revert to this target by 2025, then valuation would be a 5.1% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	94%	87%	84%	84%	82%	82%	80%	82%	82%	79%	***81%***	***81%***

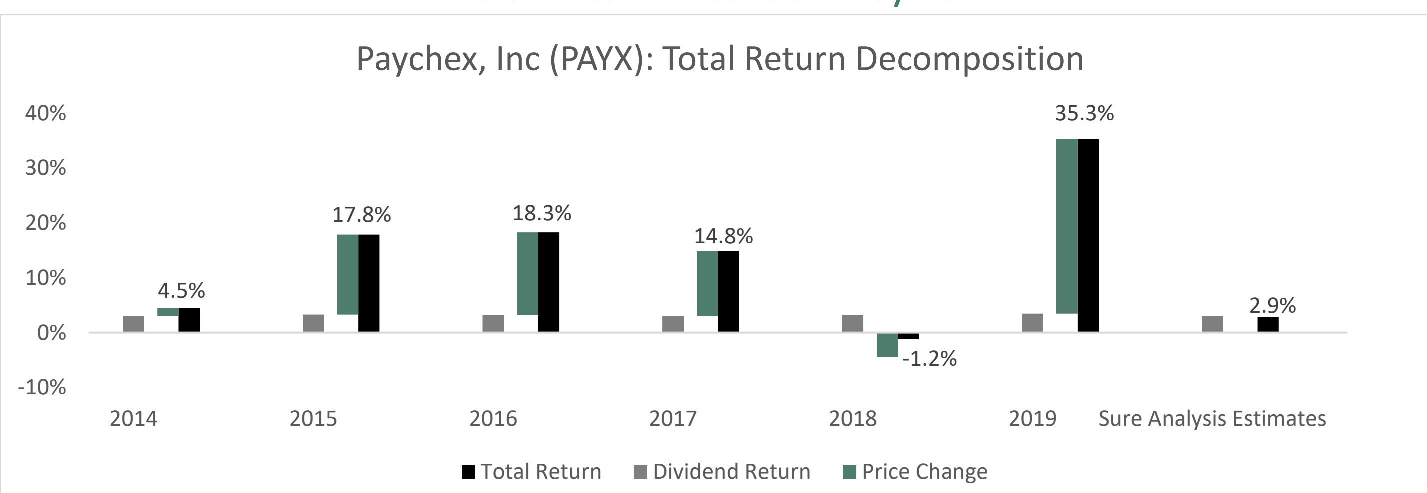
Shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances. Paychex has no long-term debt, so the company could always tap debt markets to fund an acquisition if need be.

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

Following fourth quarter and full year results, we estimate that Paychex can offer a total annual return of 2.9% through fiscal 2025, up from 0.2% previously. Much of this increase can be attribute to our belief that Oasis will be a source of growth going forward. Our expected return is based on earnings growth (5%), dividends (3%) and multiple reversion (5.1%). We have increased our 2025 price target $15 to $83, but note that this is below the current share price. We are confident in Paychex's ability to remain a leadership position in its industry, but the stock's potential return earns a sell recommendation from Sure Dividend at this time.

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.