Paychex, Inc (PAYX)

Updated October 2nd, 2019 by Nathan Parsh

Key Metrics

Current Price:	$83	**5 Year CAGR Estimate:**	3.3%	**Volatility Percentile:**	24.1%
Fair Value Price:	$65	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	75.3%
% Fair Value:	129%	**5 Year Valuation Multiple Estimate:**	-4.8%	**Growth Percentile:**	38.9%
Dividend Yield:	3.0%	**5 Year Price Target**	$83	**Valuation Percentile:**	17.9%
Dividend Risk Score:	F	**Retirement Suitability Score:**	F	**Total Return Percentile:**	15.2%

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 $30 billion and generated almost $4 billion in sales in fiscal 2019. Paychex completed its $1.2 billion purchase of Oasis Outsourcing Acquisition Corp on 12/21/2018. Oasis serves more than 8,400 clients and 1.4 million employees.

Paychex reported earnings results for the first quarter of fiscal 2020 on 10/2/2019. Adjusted earnings-per-share came to $0.71 per share, a 6% increase from the previous year and $0.02 above estimates. Revenue increased 15% to $992 million, which was $2 million above estimates.

The Management Solutions segment grew revenues 5% to $724.5 million. Increases in client bases across services was the primary contributor to growth. Revenue per client was also higher due to price increases while retirement services benefited from higher asset fee revenues. PEO and Insurance Service grew 56% in the quarter. This segment benefited from the acquisition of Oasis, which added 10% to the growth of total revenues. Also aiding results was a rise in the number of clients and client worksite employees in the existing PEO division. Interest on funds held for clients improved 20% on higher average interest rates while funds held for clients was higher by 1%. Paychex repurchased $171.9 million worth of stock during the first quarter.

Paychex raised its earnings-per-share guidance for the fiscal year following first quarter results and now expects to earn $3.10 per share, up from $3.08 previously.

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	***$3.10***	***$3.96***
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[1]	361	361	362	365	363	361	360	359	359	359	***358***	***358***

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.

[1] Share count in millions

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.

Paychex, Inc (PAYX)

Updated October 2nd, 2019 by Nathan Parsh

Paychex has increased its dividend for the past 9 years, with an average raise of 7.5% annually over the past 5 years. The company increased its dividend by 10.7% for the 5/30/2019 payment. With a high dividend payout, we feel that Paychex will be able to grow its dividend in line with earnings.

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	***26.8***	***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 decreased $1, or 1.2%, since our 6/26/2019 update. Based on expected earnings-per-share for the current fiscal year, the stock has a P/E ratio of 26.8. 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 4.8% 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%	***80%***	***80%***

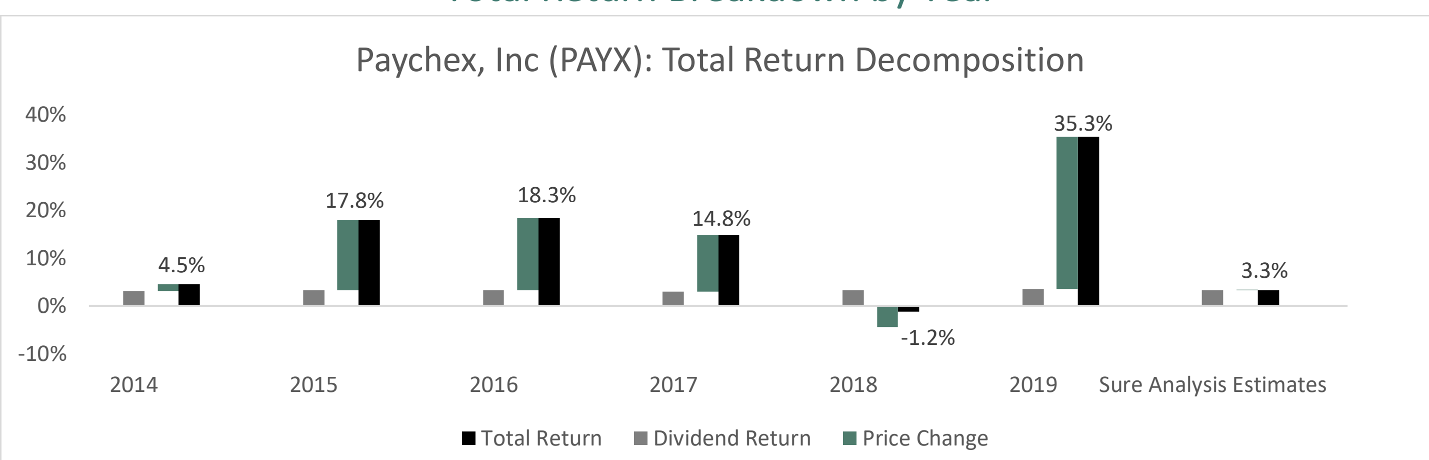
Shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances.

Paychex'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 reviewing first quarter results, we forecast that Paychex can offer a total annual return of 3.3% through fiscal 2025, up from our previous estimate of 2.9%. The company saw growth across its different businesses, with the Oasis acquisition proving to be especially fruitful. That said, the stock trades with an elevated valuation, greatly reducing our expectations for total return over the next five years. In addition, the company has a very dividend high payout ratio, which could lead to muted dividend growth. We note that the stock trades very close to our 2025 price target of $83. As such, we maintain our sell rating on Paychex.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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.

Paychex, Inc (PAYX)

Updated October 2nd, 2019 by Nathan Parsh

Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2001	2084	2230	2326	2519	2740	2952	3153	3378	3773
Gross Profit	1347	1433	1560	1655	1786	1932	2095	2234	2360	2595
Gross Margin	67.3%	68.7%	69.9%	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%
SG&A Exp.	622.4	646.4	705.8	750.1	803.7	878	948.2	979.7	1068	1223.4
D&A Exp.	86.5	88.7	97.8	98.2	105	106.6	115.1	126.9	138	181.5
Operating Profit	725	786	854	905	983	1054	1147	1254	1292	1371
Operating Margin	36.2%	37.7%	38.3%	38.9%	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%
Net Profit	477	515.3	548	569	627.5	674.9	756.8	826.3	994.1	1034.4
Net Margin	23.8%	24.7%	24.6%	24.5%	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%
Free Cash Flow	550	615	617	577	797	792	921	866	1122	1148
Income Tax	252.3	276.9	312.3	342.4	360.6	385.1	394.3	432.8	306	333.6

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5226	5394	6480	6164	6370	6468	6441	6834	7915	8676
Cash & Equivalents	284	119	109	107	153	170	132	185	358	674
Accounts Receivable	187	161	142	133	149	177	409	508	375	421
Goodwill & Int. Ass.	483	591	573	579	581	594	727	715	955	2182
Total Liabilities	3824	3898	4875	4390	4593	4682	4529	4878	5559	6057
Accounts Payable	37	45	70	43	49	52	57	57	74	76
Long-Term Debt	0	0	0	0	0	0	0	0	0	796
Shareholder's Equity	1402	1496	1605	1774	1777	1786	1912	1955	2357	2620
D/E Ratio	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.30

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	9.2%	9.7%	9.2%	9.0%	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%
Return on Equity	34.8%	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%
ROIC	34.8%	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%
Shares Out.	361.7	362.4	363	364.7	366.1	364.6	362.5	362.6	361.5	361.8
Revenue/Share	5.53	5.75	6.14	6.38	6.88	7.51	8.14	8.70	9.34	10.43
FCF/Share	1.52	1.70	1.70	1.58	2.18	2.17	2.54	2.39	3.10	3.17

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