Paychex, Inc (PAYX)

Updated December 18th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$85	**5 Year CAGR Estimate:**	2.8%	**Market Cap:**	$30B
Fair Value Price:	$65	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	1/31/2020
% Fair Value:	131%	**5 Year Valuation Multiple Estimate:**	-5.2%	**Dividend Payment Date:**	2/14/2020[1]
Dividend Yield:	2.9%	**5 Year Price Target**	$83	**Years Of Dividend Growth:**	9
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	10.7%

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 second quarter of fiscal 2020 on 12/18/2019. Adjusted earnings-per-share grew 7.7% to $0.70 per share, which was $0.02 above estimates. Revenue increased 15% to $991 million, which was slightly above estimates.

The Management Solutions segment grew revenues 6% to $726.7 million. The addition of Oasis added less than 1% of this growth. A higher number of clients and an increase in revenue per client, especially in the areas of retirement solutions and HR outsourcing, contributed the bulk of this year-over-year growth for this segment. PEO and Insurance Service grew 57% to $244 million. This segment benefited from the acquisition of Oasis, which added 47% of the growth of total revenues. An increase in clients and client worksite employees also aided results. Interest on funds held for clients was up 9% from the previous year due to higher realized gains, investment balances and interest rates. Funds held for clients inched up 2%. We continue to expect Paychex to earn $3.10 per share for fiscal 2020.

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[2]	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. 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.

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[1] Estimated dividend payment date

[2] Share count in millions

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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	***27.4***	***21.0***
Avg. Yld.	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	***2.9%***	***3.8%***

Shares of Paychex have increased $2, or 2.4%, since our 10/2/2019 update. Based on expected earnings-per-share for the current fiscal year, the stock has a P/E ratio of 27.4. 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 5.2% 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%***

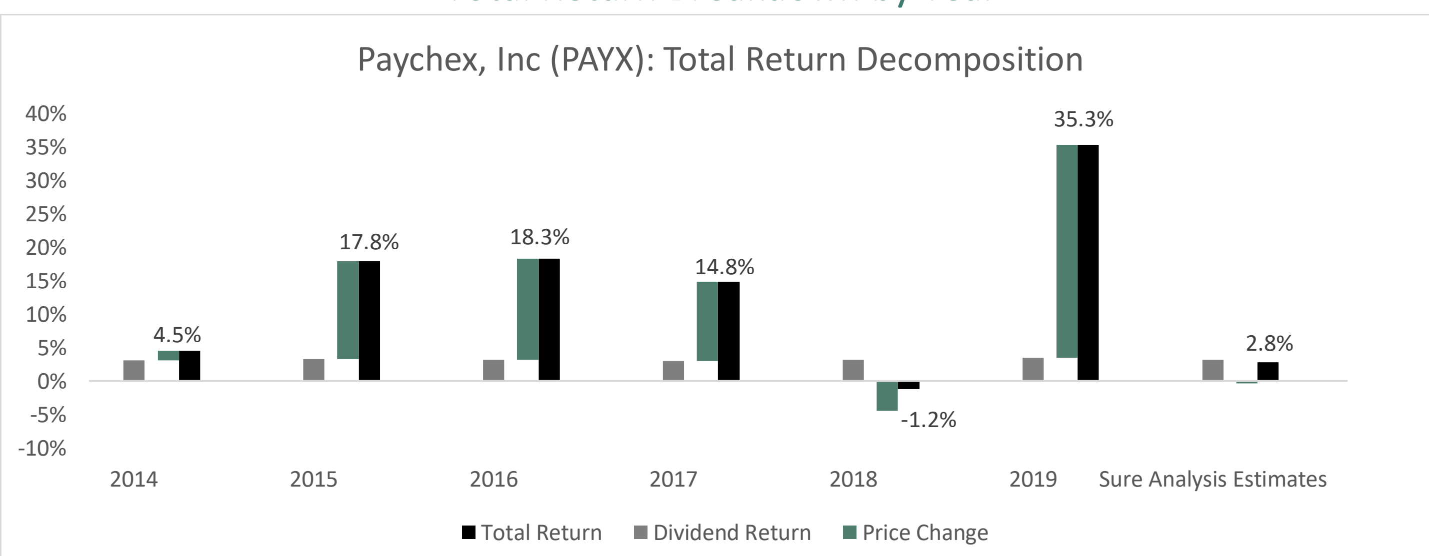
Shares of Paychex weren't immune to lower earnings numbers during the last recession. With that said, the company held up pretty well given the circumstances. Paychex has no long-term debt, so the company could always tap debt markets to fund an acquisition if need be.

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

Paychex produced yet another solid quarter. Earnings-per-share increased at a high-single-digit rate while revenue continues to be especially strong, due in large part to the acquisition of Oasis. The company's strength has been reflected in the share price, which trades above our five-year price target of $83. Shares of Paychex are projected to offer a total annual return of just 2.8% over the next five years, down from our previous estimate of 3.3%. Due to mediocre projected returns, Paychex receives a sell recommendation from Sure Dividend at this time.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue										
Gross Profit										
Gross Margin										
SG&A Exp.										
D&A Exp.										
Operating Profit										
Operating Margin										
Net Profit										
Net Margin										
Free Cash Flow										
Income Tax										

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets										
Cash & Equivalents										
Accounts Receivable										
Goodwill & Int. Ass.										
Total Liabilities										
Accounts Payable										
Long-Term Debt										
Shareholder's Equity										
D/E Ratio										

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets										
Return on Equity										
ROIC										
Shares Out.										
Revenue/Share										
FCF/Share										

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