Paychex, Inc (PAYX)

Updated March 25th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	10.8%	**Market Cap:**	$21.5 billion
Fair Value Price:	$67	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date:**	5/14/2020
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.3%	**Dividend Payment Date:**	5/29/2020[1]
Dividend Yield:	4.1%	**5 Year Price Target**	$86	**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, and 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 $21 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.

The Federal Reserve cut its baseline interest rate range to 0 to 0.25% in due to the impact of the COVID-19 on the economy. This will impact Paychex's interest of funds held for clients in the coming quarters. COVID-19 is likely an impact on the economy as consumers head the warnings of government officials and stay home. Congress and the White House are working on a stimulus package of nearly $2 trillion to help companies of all sizes during this time to help businesses remain open. Paychex noted that they are still evaluating the impact of COVID-19 on its business.

Paychex reported third quarter of fiscal 2020 earnings results on 3/25/2020. Adjusted earnings-per-share grew 9% to $0.97 per share, which was $0.03 higher than the analyst community had expected. Revenue increased 6.5% to $1.14 billion, which was in-line with estimates. The Management Solutions division had revenue of $850 million in the quarter, representing growth of 6% from the previous year. Higher client base was the main contributor to growth in the quarter, but revenue per client was also up due to higher price realization and growth in retirement services, time and attendance, and HR outsourcing. Sales for PEO and Insurance Service grew 10% due to growth in clients in the PEO business and a higher number of health and benefit clients. Interest on funds held for clients was lower by 7% due largely to lower average interest rates. Higher average investment balances and realized gains helped to offset lower interest rates. The company now expects to earn $3.20 per share for fiscal 2020, up from $3.10 previously, on revenue of $4.07 billion to $4.1 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	***$3.20***	***$4.08***
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

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[1] Estimated dividend payment date

[2] Share count in millions

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.

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	***18.8***	***21.0***
Avg. Yld.	4.2%	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	***4.1%***	***3.7%***

Shares of Paychex have decreased $25, or 29%, since our 12/18/2019 update largely due to the market wide selloff that has taken place over the past few weeks. Based on expected earnings-per-share for the current fiscal year, the stock has a P/E ratio of 18.8, its lowest valuation in some time. For context, shares of Paychex have an average P/E of 22.7 over the last ten years. We reaffirm our target P/E to 21. If shares were to revert to this target by 2025, then valuation would be a 2.3% tailwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

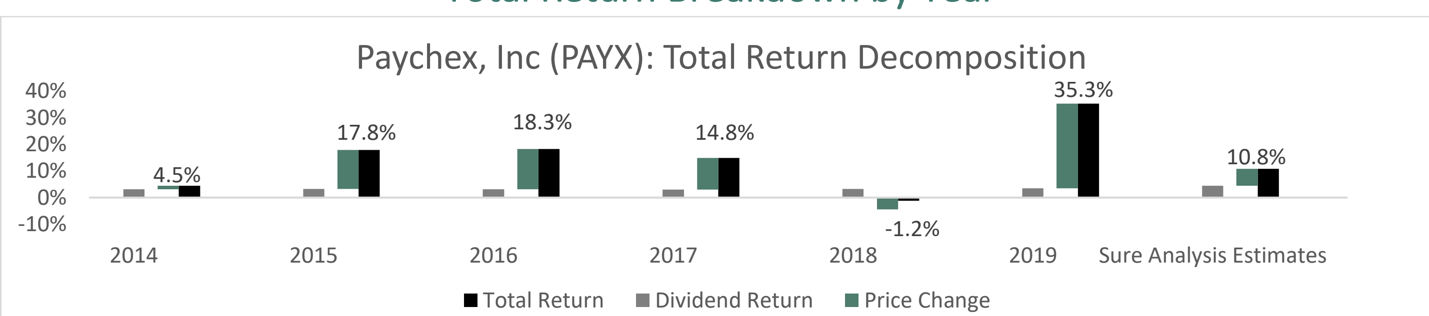
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	94%	87%	84%	84%	82%	82%	80%	82%	82%	79%	***78%***	***78%***

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. Another advantage is that Paychex has no long-term 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 is now expected to offer a total annual return of 10.8% through 2025, up from our previous estimate of 2.8%. The stock, like much of the market, has been in the midst of a sell off related to COVID-19. Still, Paychex delivered a solid quarter and raised its earnings-per-share guidance for the fiscal year. Investors should note the possibility of small and medium size businesses feeling the impact of COVID-19, but those waiting for an entry point into Paychex should consider purchasing the stock at current levels. Paychex now receives a buy recommendation from Sure Dividend due to projected returns, up from a sell previously. We have increased our 2025 price target $4 to $86 due to revised guidance.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	2,001	2,084	2,230	2,326	2,519	2,740	2,952	3,153	3,378	3,773
Gross Profit	1,347	1,433	1,560	1,655	1,786	1,932	2,095	2,234	2,360	2,595
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	646	706	750	804	878	948	980	1,068	1,223
D&A Exp.	87	89	98	98	105	107	115	127	138	182
Operating Profit	725	786	854	905	983	1,054	1,147	1,254	1,292	1,371
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	548	569	628	675	757	826	994	1,034
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	1,122	1,148
Income Tax	252	277	312	342	361	385	394	433	306	334

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5,226	5,394	6,480	6,164	6,370	6,468	6,441	6,834	7,915	8,676
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	2,182
Total Liabilities	3,824	3,898	4,875	4,390	4,593	4,682	4,529	4,878	5,559	6,057
Accounts Payable	37	45	70	43	49	52	57	57	74	76
Long-Term Debt	-	-	-	-	-	-	-	-	-	796
Shareholder's Equity	1,402	1,496	1,605	1,774	1,777	1,786	1,912	1,955	2,357	2,620
D/E Ratio	-	-	-	-	-	-	-	-	-	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	361	362	365	363	361	360	359	359	359
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.