Paychex, Inc (PAYX)

Updated October 6th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$79	**5 Year CAGR Estimate:**	3.3%	**Market Cap:**	$28.6 billion
Fair Value Price:	$59	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	10/30/2020[1]
% Fair Value:	135%	**5 Year Valuation Multiple Estimate:**	-5.8%	**Dividend Payment Date:**	11/20/2020[2]
Dividend Yield:	3.1%	**5 Year Price Target**	$78	**Years Of Dividend Growth:**	9
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	10.7%

Overview & Current Events

Paychex, Inc, which was incorporated in 1979, provides payroll accounting, benefits and human resource services to businesses that employ between 10 and 200 employees. Paychex provides services to more than 680,000 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.

The Federal Reserve recently 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 ongoing impact on the economy as the virus continues to spread.

Paychex announced earnings results for the first quarter of fiscal year 2021 on 10/6/2020. Revenue declined 6% to $932 million, but was $44 million higher than expected. Adjusted earnings-per-share declined 11.3% to $0.63, but topped estimates by $0.08.

Management Solutions' revenue of $687.4 million was a decrease of 5% year-over-year. This decline was driven by a decline in check volumes due to a lower number of processed payrolls and fewer employees being paid. This was partially offset by an increase in retirement services. PEO and Insurance Solutions' revenues of $229.9 million were down 7%. This was attributed to fewer worksite employees. Insurance was down as a result of lower workers' compensation premiums. Interest on funds held for clients was lower by 28% to $14.9 million due to a combination of lower average investment balances, realized gains, and average interest rates. The company expects revenue to decline 2% to 4% in fiscal 2021, slightly better than consensus estimates. Earnings-per-share is expected to be decline 6% to 8% from the previous year compared to consensus estimates of down 8.2%. We have raised our 2021 EPS estimates $0.03 to $2.79 to account for the company's guidance.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.42	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	$3.00	***$2.79***	***$3.73***
DPS	$1.24	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	$2.48	***$2.48***	***$3.17***
Shares[3]	361	362	365	363	361	360	359	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 is low, Paychex should see earnings continue to grow. If unemployment remains elevated, 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 are raising our expected EPS growth rate to 6% from 5% as we believe that Paychex will see a

[1] Estimated ex-dividend date
[2] Estimated dividend payment date
[3] 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.

more meaningful earnings growth rate as recovery from the COVID-19 pandemic takes, place and more employees return to work.

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 need to grow earnings in order to continue growing its dividend. We note the company has not yet raised its dividend this year on its normal cadence.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Avg. P/E	20.7	19.6	21.4	24.1	24.8	24.0	26.2	25.1	29.6	24.1	***28.3***	***21.0***
Avg. Yld.	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	***3.1%***	***4.0%***

Shares of Paychex have increased $5, or 6.8%, since our 7/7/2020 update. Based on expected earnings-per-share for the current fiscal year, the stock has a P/E ratio of 28.3. 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 fiscal 2026, then valuation would be a 5.8% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

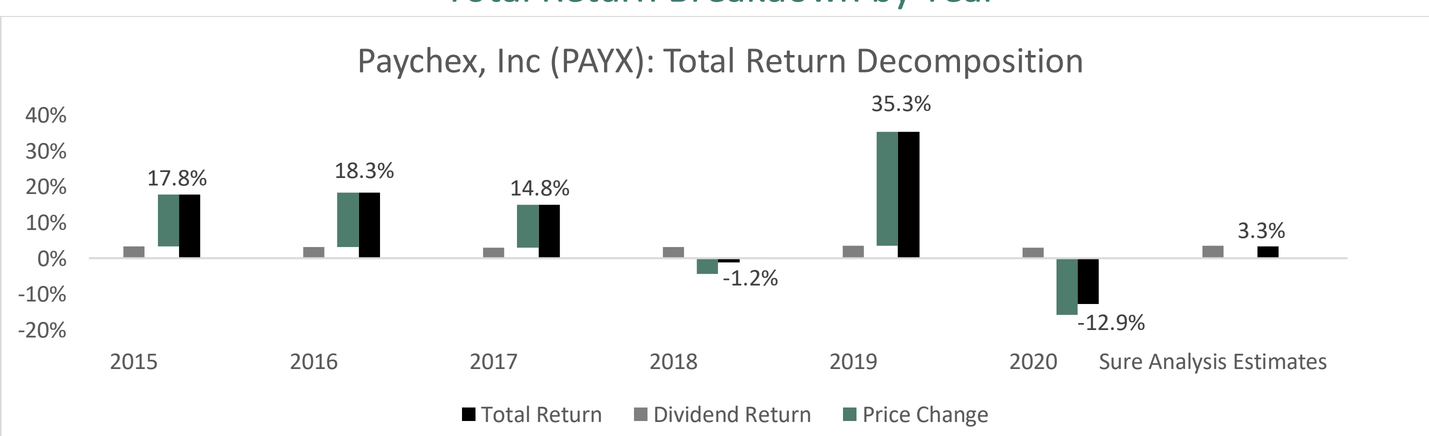
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	87%	84%	84%	82%	82%	80%	82%	82%	79%	83%	***89%***	***85%***

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 very little 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 in 2018.

Final Thoughts & Recommendation

Following first quarter, Paychex is now projected to offer a total annual return of 3.3% through fiscal 2026, down from our previous estimate of 4.4%. Both the business and stock continue to hold up decently despite the difficult environment that Paychex faces. The company's guidance was better than expected, but it will be difficult for the share price to grow until a meaningful recovery from the COVID-19 pandemic occurs. Paychex continues to receive a hold recommendation from Sure Dividend due to expected total returns over the next five years.

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	362	365	363	361	360	359	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.