Paychex, Inc (PAYX)

Updated April 7th, 2021 by Nathan Parsh

Key Metrics

Current Price:	$95	**5 Year CAGR Estimate:**	0.6%	**Market Cap:**	$34.4 billion
Fair Value Price:	$62	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	5/14/2021[1]
% Fair Value:	152%	**5 Year Valuation Multiple Estimate:**	-8.1%	**Dividend Payment Date:**	5/28/2021[2]
Dividend Yield:	2.6%	**5 Year Price Target**	$83	**Years Of Dividend Growth:**	9
Dividend Risk Score:	D	**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 about 700,000 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 announced earnings results for the third quarter of fiscal year 2021 on April 6, 2021 (the company's fiscal year ends May 31st). Revenue declined 2.6% to $1.11 billion and was in-line with estimates. Adjusted earnings-per-share fell 1% to $0.96, which was $0.04 better than expected.

Revenue for the Management Solutions revenue of $846.8 million was essentially flat from the prior year. Higher client base and strength in HR outsourcing, retirement services and time and attendance was offset by lower check volumes due to fewer employees for clients. PEO and Insurance Solutions' revenues declined 8% to $249.8 million. Fewer worksite employees, a decline in state unemployment insurance and lower compensation premiums due to reduced wages were headwinds during the quarter. Interest of funds held for clients was down 29% to $15.1 million on account of lower interest rates and realized gains though average investment balances were consistent. Paychex had more than $1 billion in cash and equivalents as of the end of February.

Adjusted earnings-per-share are now expected in a range of $2.94 to $3.00, up from a prior range of $2.88 to $2.97. This range implies adjusted earnings-per-share of down 2% to flat from the previous fiscal year.

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	***$2.97***	***$3.97***
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	***360***	***360***

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

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[1] Estimated ex-dividend date
[2] Estimated dividend payment date
[3] Share count in millions

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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. Shareholders have received the same payment for seven consecutive quarters.

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	***32.0***	***21.0***
Avg. Yld.	4.2%	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	***2.6%***	***3.8%***

Shares of Paychex have decreased $1, or 1%, since our 12/23/2020 update. Based on updated estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 32. 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 an 8.1% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

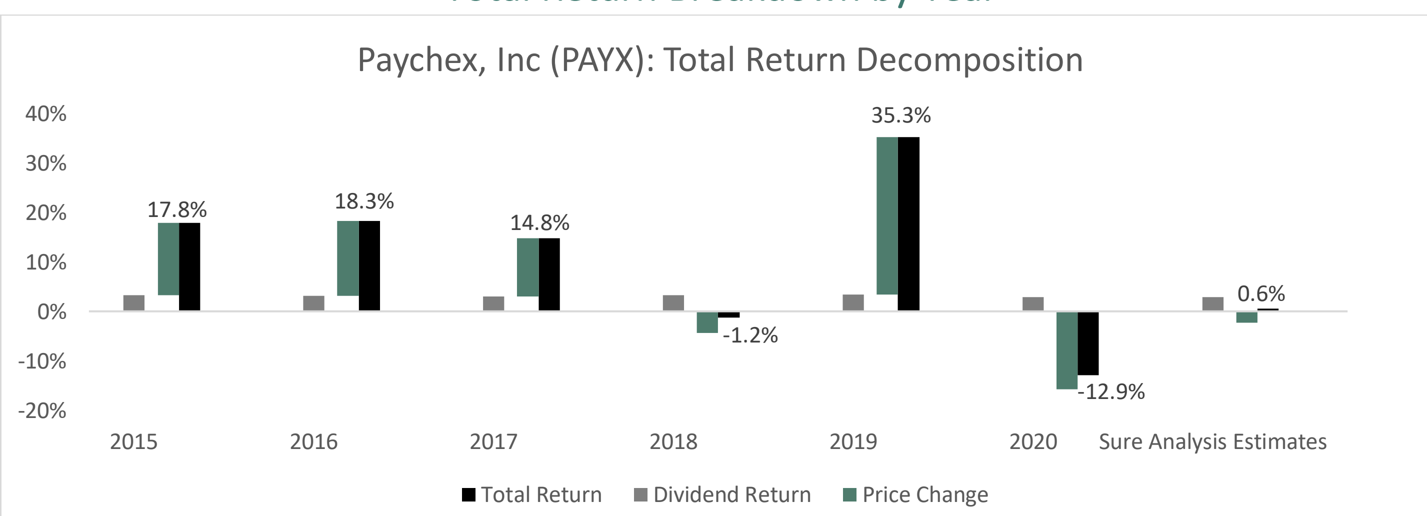
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	87%	84%	84%	82%	82%	80%	82%	82%	79%	83%	***84%***	***80%***

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. 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.

Final Thoughts & Recommendation

Following third quarter results, Paychex is now projected to offer a total annual return of 0.6% through fiscal 2026, up from our previous estimate of 0.2%. We expect that a 6% earnings growth rate and 2.6% dividend yield will be nearly offset by a high single-digit multiple reversion over the next five years. Overall, Paychex has performed well during the COVID-19 pandemic even in the face of higher unemployment. We have raised our five-year price target $1 to $83 due to updated guidance, but maintain our sell rating on Paychex due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2,084	2,230	2,326	2,519	2,740	2,952	3,153	3,378	3,773	4,041
Gross Profit	1,433	1,560	1,655	1,786	1,932	2,095	2,234	2,360	2,595	2,760
Gross Margin	68.7%	69.9%	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%	68.3%
SG&A Exp.	646	706	750	804	878	948	980	1,068	1,223	1,299
D&A Exp.	89	98	98	105	107	115	127	138	182	210
Operating Profit	786	854	905	983	1,054	1,147	1,254	1,292	1,371	1,461
Operating Margin	37.7%	38.3%	38.9%	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%	36.1%
Net Profit	515	548	569	628	675	757	826	994	1,034	1,098
Net Margin	24.7%	24.6%	24.5%	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%	27.2%
Free Cash Flow	615	617	577	797	792	921	866	1,122	1,148	1,314
Income Tax	277	312	342	361	385	394	433	306	334	339

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	5,394	6,480	6,164	6,370	6,468	6,441	6,834	7,915	8,676	8,551
Cash & Equivalents	119	109	107	153	170	132	185	358	674	905
Accounts Receivable	161	142	133	149	177	409	508	375	421	384
Goodwill & Int. Ass.	591	573	579	581	594	727	715	955	2,182	2,122
Total Liabilities	3,898	4,875	4,390	4,593	4,682	4,529	4,878	5,559	6,057	5,769
Accounts Payable	45	70	43	49	52	57	57	74	76	79
Long-Term Debt	-	-	-	-	-	-	-	-	796	802
Shareholder's Equity	1,496	1,605	1,774	1,777	1,786	1,912	1,955	2,357	2,620	2,781
D/E Ratio	-	-	-	-	-	-	-	-	0.30	0.29

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	9.7%	9.2%	9.0%	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%	12.7%
Return on Equity	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%	40.7%
ROIC	35.6%	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%	31.4%
Shares Out.	361	362	365	363	361	360	359	359	359	359
Revenue/Share	5.75	6.14	6.38	6.88	7.51	8.14	8.70	9.34	10.43	11.19
FCF/Share	1.70	1.70	1.58	2.18	2.17	2.54	2.39	3.10	3.17	3.64

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

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