Paychex, Inc (PAYX)

Updated October 3rd, 2021 by Nathan Parsh

Key Metrics

Current Price:	$115	**5 Year CAGR Estimate:**	2.5%	**Market Cap:**	$41 billion
Fair Value Price:	$86	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	10/29/2021[1]
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.6%	**Dividend Payment Date:**	11/24/2021[2]
Dividend Yield:	2.3%	**5 Year Price Target**	$115	**Years Of Dividend Growth:**	10
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	6.5%

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 first quarter of fiscal year 2021 on September 30th, 2021 (the company's fiscal year ends May 31st). For the quarter, revenue grew 16.2% to $1.08 billion, $40 million better than expected. Adjusted earnings-per-share of $0.89 was a 42% improvement from the prior year and $0.09 above estimates.

Revenue for the Management Solutions segment increased 17% to $805.5 million. Growth was driven by a higher client base as well as a deeper penetration of HR outsourcing and time and attendance products. An increase in employees returning to work led to higher checks per client and higher prices drove higher revenue per check. PEO & Insurance Solutions grew 14% to $262.9 million. Growth was caused by the combination of a higher number of worksite employees and an increase in wages per employee. Paychex also saw strength in its health insurance business. Interest of funds held for clients fell 3% to $14.5 million as higher average investment balances were more than offset by lower average interest rates. Paychex had $1.2 billion in cash and equivalents as of the end of August.

Paychex also provided revised guidance for the fiscal year. Revenue is expected to grow approximately 8%, up from 7% previously, and adjusted earnings-per-share are anticipated to improve 12% to 14%, up from 10% to 12% previously. We have adjusted our earnings-per-share target for the fiscal year accordingly.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.51	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	$3.00	$3.04	***$3.44***	***$4.60***
DPS	$1.27	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	$2.48	$2.52	***$2.64***	***$3.37***
Shares[3]	362	365	363	361	360	359	359	359	359	360	***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 8.1% per year over the past decade. We reaffirm our EPS growth rate to 6% as we believe that Paychex will see meaningful earnings growth rate as recovery from the COVID-19 pandemic takes, place and more employees return to work.

[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 10 years, with an average raise of 8.4% annually over the past 5 years. The company increased its dividend by 6.5% for the 5/27/2021 payment. Shareholders had received the same payment for eight consecutive quarters. With a high dividend payout, we feel that Paychex will need to grow earnings in order to continue growing its dividend.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Avg. P/E	19.6	21.4	24.1	24.8	24.0	26.2	25.1	29.6	24.1	33.3	***33.4***	***25.0***
Avg. Yld.	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	2.5%	***2.3%***	***2.9%***

Shares of Paychex have increased $9, or 8.6%, since our 6/25/2021 update. Based on updated estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 33.4. For context, shares of Paychex have an average P/E of 25.2 over the last ten years. We reaffirm our target P/E of 25 as this is more in-line with the stock's long-term average valuation. If shares were to revert to this target by fiscal 2027, then valuation would be an 5.6% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

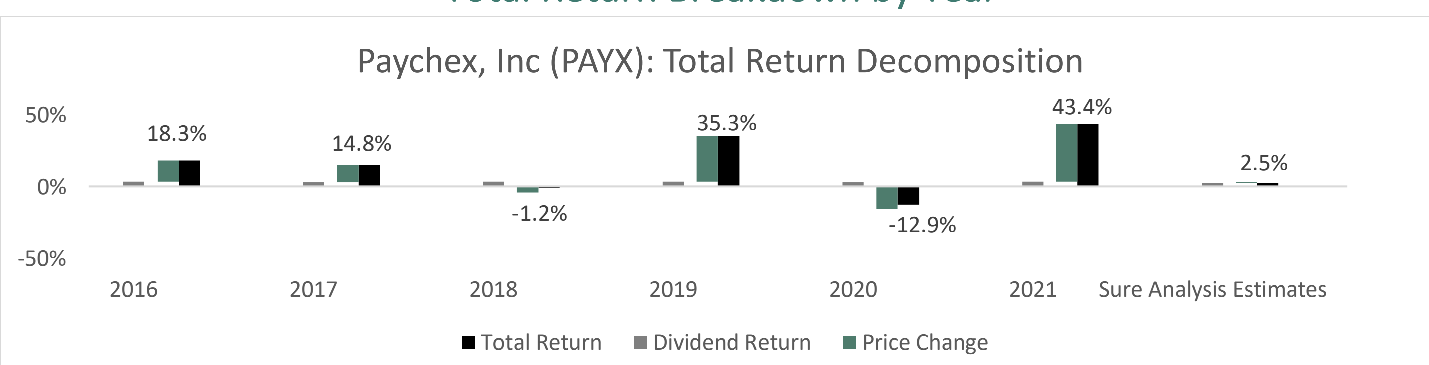
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	84%	84%	82%	82%	80%	82%	82%	79%	83%	82%	***77%***	***73%***

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

After first quarter results, Paychex is now projected to offer a total annual return of 2.5% through fiscal 2027, down from our previous estimate of 3.9%. We expect that a 6% earnings growth rate and 2.3% dividend yield will be partially offset by a mid-single-digit multiple reversion over the next five years. The company continues to lap the weakest parts of the prior year as this was the period of time that COVID-19 most heavily impacted Paychex's business. The most recent quarter actually compares very favorably to pre-pandemic results, showing that Paychex has largely come through the worst of the crisis in an arguably stronger manner. That said, shares trade well above their long-term average valuation. We have raised our five-year price target $2 to $115, but view shares as a sell due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	2,230	2,326	2,519	2,740	2,952	3,153	3,378	3,773	4,041	4,057
Gross Profit	1,560	1,655	1,786	1,932	2,095	2,234	2,360	2,595	2,760	2,786
Gross Margin	69.9%	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%	68.3%	68.7%
SG&A Exp.	706	750	804	878	948	980	1,068	1,223	1,299	1,325
D&A Exp.	98	98	105	107	115	127	138	182	210	192
Operating Profit	854	905	983	1,054	1,147	1,254	1,292	1,371	1,461	1,461
Operating Margin	38.3%	38.9%	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%	36.1%	36.0%
Net Profit	548	569	628	675	757	826	994	1,034	1,098	1,098
Net Margin	24.6%	24.5%	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%	27.2%	27.1%
Free Cash Flow	617	577	797	792	921	866	1,122	1,148	1,314	1,146
Income Tax	312	342	361	385	394	433	306	334	339	337

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	6,480	6,164	6,370	6,468	6,441	6,834	7,915	8,676	8,551	9,227
Cash & Equivalents	109	107	153	170	132	185	358	674	905	995
Accounts Receivable	142	133	149	177	409	508	375	421	384	578
Goodwill & Int. Ass.	573	579	581	594	727	715	955	2,182	2,122	2,097
Total Liabilities	4,875	4,390	4,593	4,682	4,529	4,878	5,559	6,057	5,769	6,279
Accounts Payable	70	43	49	52	57	57	74	76	79	89
Long-Term Debt	-	-	-	-	-	-	-	796	802	805
Shareholder's Equity	1,605	1,774	1,777	1,786	1,912	1,955	2,357	2,620	2,781	2,948
D/E Ratio	-	-	-	-	-	-	-	0.30	0.29	0.27

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	9.2%	9.0%	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%	12.7%	12.3%
Return on Equity	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%	40.7%	38.3%
ROIC	35.3%	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%	31.4%	29.9%
Shares Out.	362	365	363	361	360	359	359	359	359	360
Revenue/Share	6.14	6.38	6.88	7.51	8.14	8.70	9.34	10.43	11.19	11.20
FCF/Share	1.70	1.58	2.18	2.17	2.54	2.39	3.10	3.17	3.64	3.16

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