Paychex, Inc (PAYX)

Updated March 30th, 2022 by Nathan Parsh

Key Metrics

Current Price:	$137	**5 Year CAGR Estimate:**	2.1%	**Market Cap:**	$48 billion
Fair Value Price:	$99	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	05/11/22[1]
% Fair Value:	147%	**5 Year Valuation Multiple Estimate:**	-7.4%	**Dividend Payment Date:**	05/27/22[2]
Dividend Yield:	1.9%	**5 Year Price Target**	$137	**Years Of Dividend Growth:**	10
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Sell

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 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 & Insurance, which offers outsourced human resource services and insurance.

Paychex announced earnings results for the third quarter of fiscal year 2022 on December 22nd, 2021 (the company's fiscal year ends May 31st). Revenue increased nearly 15% to $1.28 billion, beating estimates by $57 million. Adjusted earnings-per-share of $1.15 compared to $0.96 in the prior year and was $0.10 above expectations.

Revenue for the Management Solutions segment grew 13% to $959.9 million. Strong demand for HR solutions, growth in checks per payroll and higher worksite employee headcount were the primary reasons for the increase in revenue. Higher price realization also contributed to results. PEO & Insurance Solutions was up 21% to $301.7 million. Higher average worksite employees along with an increase in average wages per employee was once again the primary contributor to results. This segment also benefited from an increase in revenue from both health insurance and state unemployment insurance. Interest of funds held for clients deceased 5% to $14.4 million as higher average investment balances were more than offset by lower average interest rates.

Paychex once again provided revised guidance for the fiscal year. Revenue is expected to grow 12% to 13%, up from 10% to 11% and up from 8% and 7%, previously. Adjusted earnings-per-share is now expected to grow 22.5% to 23%, up from 18% to 20%, 12% to 14%, and 10% to 12%, previously. We have updated 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	***$3.73***	***$5.48***
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	***361***	***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 are raising our expected EPS growth rate to 8% from 6% to better reflect the company's historical performance and recent business results.

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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 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	***36.7***	***25.0***
Avg. Yld.	4.3%	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	2.5%	***1.9%***	***2.5%***

Shares of Paychex have increased $2, or 1.5%, since our 12/22/2021 update. Based off of updated estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 36.7. 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 7.4% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

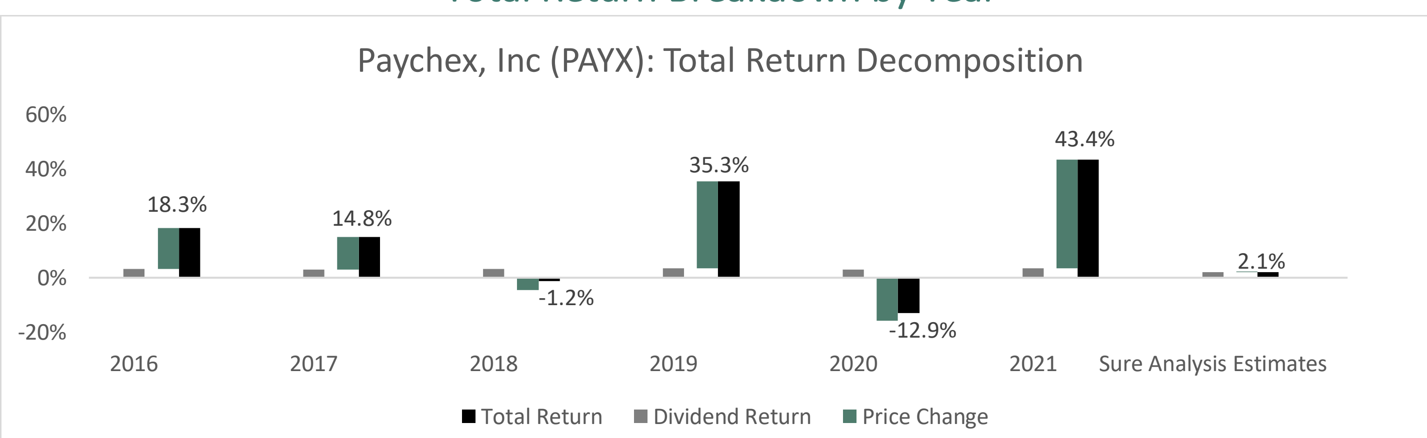
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	84%	84%	82%	82%	80%	82%	82%	79%	83%	82%	***71%***	***61%***

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 2.1% through fiscal 2027, up slightly from our previous estimate of 1.9%. We expect that an 8% earnings growth rate and 1.9% dividend yield will be nearly offset by a high single-digit valuation reversion over the next five years. Paychex continues to produce strong growth rates in both of its business, but the valuation remains well ahead of where it typically resides. We feel that this leaves open the strong possibility of significant multiple compression over the next five years. As such, we continue to rate shares of Paychex as a sell.

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
LTD/E Ratio	3.04	2.47	2.58	2.62	2.37	2.50	2.36	2.31	2.07	2.13

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.