Paychex, Inc (PAYX)

Updated December 26th, 2022 by Nathan Parsh

Key Metrics

Current Price:	$116	**5 Year CAGR Estimate:**	8.5%	**Market Cap:**	$42 billion
Fair Value Price:	$107	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	01/27/23[1]
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Dividend Payment Date:**	02/24/23[2]
Dividend Yield:	2.7%	**5 Year Price Target**	$156	**Years Of Dividend Growth:**	11
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Hold

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.

On April 29th, 2022, Paychex increased its quarterly dividend 19.7% to $0.79 per share, extending the company's dividend growth streak to 11 years.

On December 22nd, 2022, Paychex announced earnings results for the second quarter of fiscal year 2023 (the company's fiscal year ends May 31st). For the quarter, revenue grew 7.4% to $1.19 billion, beating estimates by $10 million. Adjusted earnings-per-share of $0.99 compared to $0.91 in the prior year and was $0.02 above expectations.

For the quarter, Management Solutions increased 8% to $895.3 million due to growth in clients for human capital management and a higher number of worksite employees for HR Solutions. Revenue per client increased due to better realized prices and product demand. PEO & Insurance Solutions grew 4% to $273.3 million due to higher average worksite employees. Interest on funds held for clients improved 54% to $21.7 million.

Paychex updated guidance for fiscal year 2023 as well. Revenue is expected to increase 8%, up from prior guidance of 7% to 8%. Adjusted earnings-per-share is now projected to grow 12% to 14%, up from 11% to 12% and 9% to 10% previously. We have updated our earnings-per-share target for the fiscal year accordingly.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$1.56	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	$3.00	$3.04	$3.77	***$4.26***	***$6.26***
DPS	$1.31	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	$2.48	$2.52	$2.77	***$3.16***	***$4.03***
Shares[3]	365	363	361	360	359	359	359	359	360	361	***361***	***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 10.3% per year over the past decade. We reaffirm our expected EPS growth rate of 8% 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

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.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	21.4	24.1	24.8	24.0	26.2	25.1	29.6	24.1	33.3	32.8	***27.2***	***25.0***
Avg. Yld.	3.9%	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	2.5%	2.2%	***2.7%***	***2.6%***

Shares of Paychex have decreased $1, or 0.9%, since our September 29th, 2022 report. Based off of estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 27.2. For context, shares of Paychex have an average P/E of 26.5 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 2028, then valuation would be a 1.7% headwind to total annual returns over this period of time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

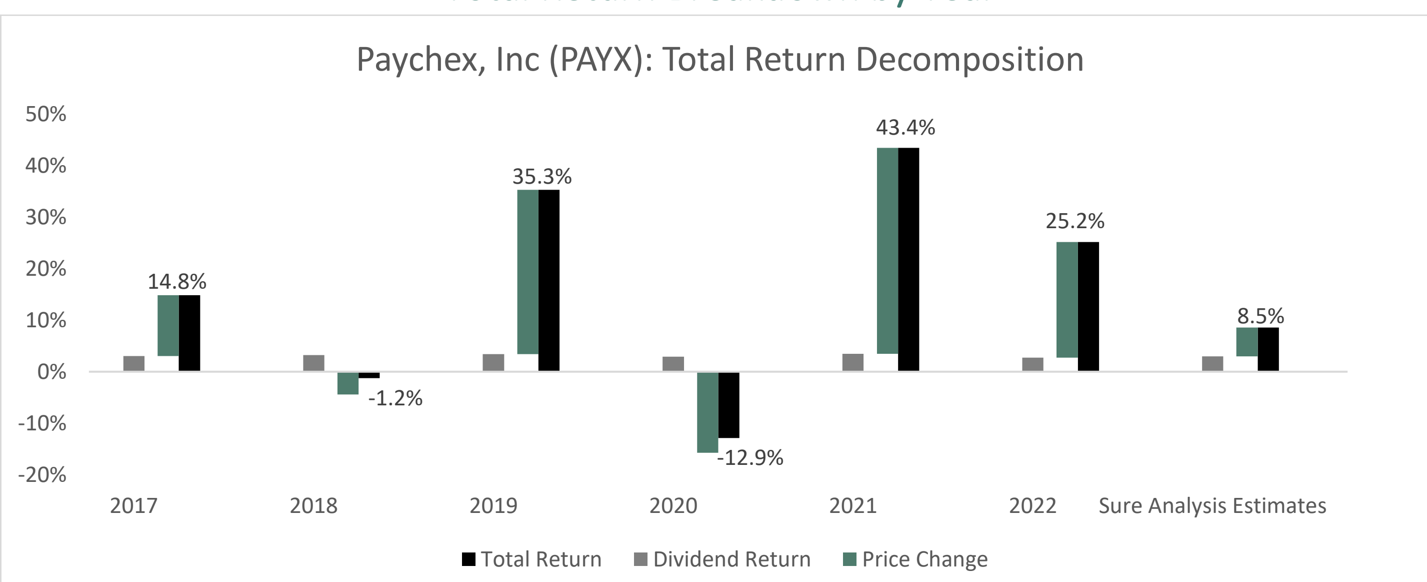
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	84%	82%	82%	80%	82%	82%	79%	83%	82%	73%	***74%***	***64%***

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 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 second quarter results, Paychex is now projected to offer a total annual return of 8.5% through fiscal 2028, up slightly from our previous estimate of 8.1%. We expect that an 8% earnings growth rate and 2.7% dividend yield will be partially offset by a low single-digit valuation reversion over the next five years. Paychex continues to see solid growth rates in both of its businesses and the company once again raised earnings guidance for the fiscal year. We have raised our five-year price target $2 to $156 to reflect this increase in guidance, but maintain our hold rating on Paychex due to projected returns. We would consider buying the stock on a further pullback.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	2,326	2,519	2,740	2,952	3,153	3,378	3,773	4,041	4,057	4,612
Gross Profit	1,655	1,786	1,932	2,095	2,234	2,360	2,595	2,760	2,786	3,255
Gross Margin	71.1%	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%	68.3%	68.7%	70.6%
SG&A Exp.	750	804	878	948	980	1,068	1,223	1,299	1,325	1,415
D&A Exp.	98	105	107	115	127	138	182	210	192	192
Operating Profit	905	983	1,054	1,147	1,254	1,292	1,371	1,461	1,461	1,840
Operating Margin	38.9%	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%	36.1%	36.0%	39.9%
Net Profit	569	628	675	757	826	994	1,034	1,098	1,098	1,393
Net Margin	24.5%	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%	27.2%	27.1%	30.2%
Free Cash Flow	577	797	792	921	866	1,122	1,148	1,314	1,146	1,373
Income Tax	342	361	385	394	433	306	334	339	337	432

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	6,164	6,370	6,468	6,441	6,834	7,915	8,676	8,551	9,227	9,635
Cash & Equivalents	107	153	170	132	185	358	674	905	995	370
Accounts Receivable	133	149	177	409	508	375	421	384	578	724
Goodwill & Int. Ass.	579	581	594	727	715	955	2,182	2,122	2,097	2,056
Total Liabilities	4,390	4,593	4,682	4,529	4,878	5,559	6,057	5,769	6,279	6,550
Accounts Payable	43	49	52	57	57	74	76	79	89	106
Long-Term Debt	-	-	-	-	-	-	796	802	805	806
Shareholder's Equity	1,774	1,777	1,786	1,912	1,955	2,357	2,620	2,781	2,948	3,085
LTD/E Ratio	-	-	-	-	-	-	0.30	0.29	0.27	0.26

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	9.0%	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%	12.7%	12.3%	14.8%
Return on Equity	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%	40.7%	38.3%	46.2%
ROIC	33.7%	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%	31.4%	29.9%	36.4%
Shares Out.	365	363	361	360	359	359	359	359	360	361
Revenue/Share	6.38	6.88	7.51	8.14	8.70	9.34	10.43	11.19	11.20	12.70
FCF/Share	1.58	2.18	2.17	2.54	2.39	3.10	3.17	3.64	3.16	3.78

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