



# Paychex, Inc (PAYX)

Updated April 10<sup>th</sup>, 2023 by Nathan Parsh

## Key Metrics

|                             |       |                                            |       |                                  |                       |
|-----------------------------|-------|--------------------------------------------|-------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$109 | <b>5 Year CAGR Estimate:</b>               | 10.0% | <b>Market Cap:</b>               | \$39 billion          |
| <b>Fair Value Price:</b>    | \$107 | <b>5 Year Growth Estimate:</b>             | 8.0%  | <b>Ex-Dividend Date:</b>         | 05/11/23 <sup>1</sup> |
| <b>% Fair Value:</b>        | 102%  | <b>5 Year Valuation Multiple Estimate:</b> | -0.4% | <b>Dividend Payment Date:</b>    | 05/26/23 <sup>2</sup> |
| <b>Dividend Yield:</b>      | 2.9%  | <b>5 Year Price Target</b>                 | \$157 | <b>Years Of Dividend Growth:</b> | 11                    |
| <b>Dividend Risk Score:</b> | C     | <b>Retirement Suitability Score:</b>       | C     | <b>Rating:</b>                   | Buy                   |

## 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 29<sup>th</sup>, 2022, Paychex increased its quarterly dividend 19.7% to \$0.79 per share, extending the company's dividend growth streak to 11 years.

On March 29<sup>th</sup>, 2023, Paychex announced earnings results for the third quarter of fiscal year 2023 (the company's fiscal year ends May 31<sup>st</sup>). For the quarter, revenue grew 7.8% to \$1.38 billion, beating estimates by \$30 million. Adjusted earnings-per-share of \$1.29 compared to \$1.15 in the prior year and was \$0.05 above expectations.

For the quarter, Management Solutions increased 7% to \$1 billion due once again 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 6% to \$321.2 million due to higher average worksite employees. Interest on funds held for clients improved 144% to \$35.3 million.

Paychex updated guidance for fiscal year 2023 as well. Revenue is still expected to increase 8%. Adjusted earnings-per-share is now projected to grow 13% to 14%, up from 12% to 14%, 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          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$1.56 | \$1.71 | \$1.85 | \$2.09 | \$2.25 | \$2.45 | \$2.84 | \$3.00 | \$3.04 | \$3.77 | <b>\$4.28</b> | <b>\$6.29</b> |
| <b>DPS</b>                | \$1.31 | \$1.40 | \$1.52 | \$1.68 | \$1.84 | \$2.18 | \$2.24 | \$2.48 | \$2.52 | \$2.77 | <b>\$3.16</b> | <b>\$4.03</b> |
| <b>Shares<sup>3</sup></b> | 365    | 363    | 361    | 360    | 359    | 359    | 359    | 359    | 360    | 361    | <b>362</b>    | <b>359</b>    |

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.

<sup>1</sup> Estimated ex-dividend date

<sup>2</sup> Estimated dividend payment date

<sup>3</sup> 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 | 25.5 | 25.0 |
| Avg. Yld. | 3.9% | 3.4% | 3.3% | 3.4% | 3.1% | 3.3% | 2.7% | 3.4% | 2.5% | 2.2% | 2.9% | 2.6% |

Shares of Paychex have decreased \$7, or 6.0%, since our December 26<sup>th</sup>, 2022 report. Based off of estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 25.5. 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 0.4% headwind to total annual returns over this period of time.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

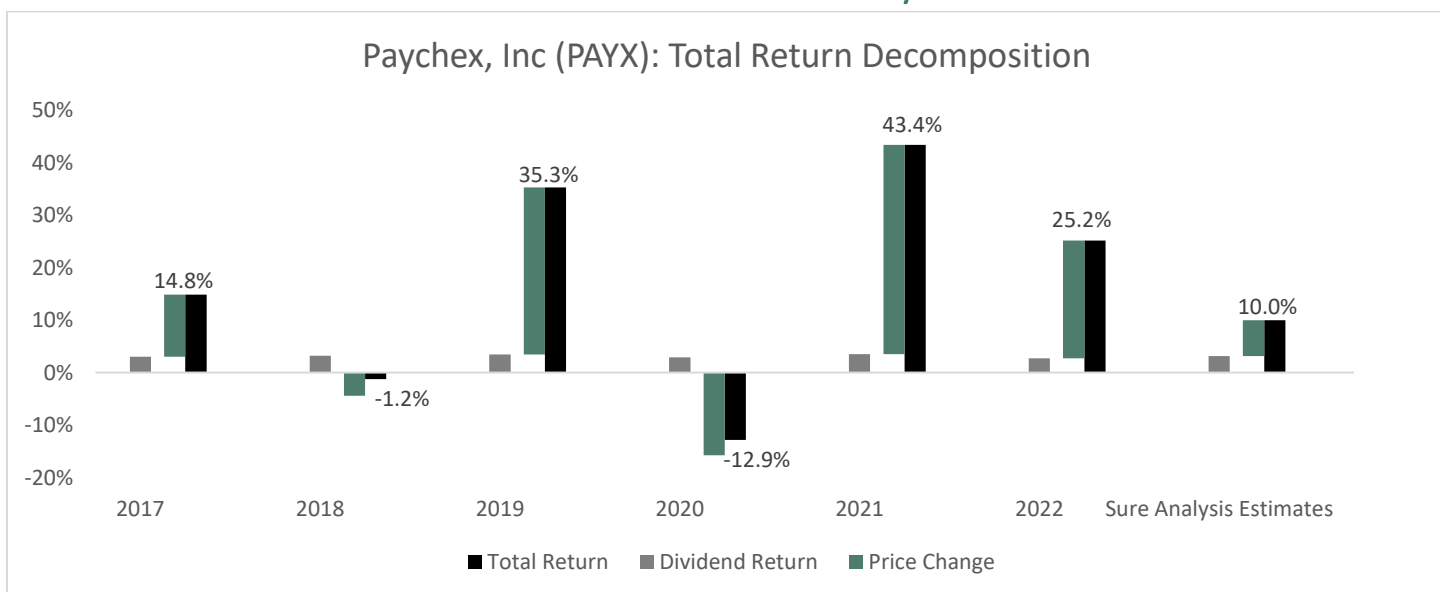
| Year   | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 84%  | 82%  | 82%  | 80%  | 82%  | 82%  | 79%  | 83%  | 82%  | 73%  | 73%  | 64%  |

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 third quarter results, Paychex is now projected to offer a total annual return of 10.0% through fiscal 2028, up slightly from our previous estimate of 8.5%. We expect that an 8% earnings growth rate and 2.9% dividend yield will be partially offset by a small valuation reversion over the next five years. Paychex once again experienced solid growth rates in both of its businesses. The company also raised earnings guidance again for the fiscal year. We have raised our five-year price target \$1 to \$157 to reflect this increase in guidance. Shares of Paychex now receive a buy rating due to projected returns.

## 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.

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