Paychex, Inc (PAYX)

Updated December 27th, 2023 by Nathan Parsh

Key Metrics

Current Price:	$120	**5 Year CAGR Estimate:**	12.0%	**Market Cap:**	$43 Billion
Fair Value Price:	$130	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	02/09/24[1]
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.6%	**Dividend Payment Date:**	02/23/24[2]
Dividend Yield:	3.0%	**5 Year Price Target**	$191	**Years Of Dividend Growth:**	12
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Rating:**	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 28th, 2023, Paychex increased its quarterly dividend 12.7% to $0.89 per share, extending the company's dividend growth streak to 12 years.

On December 21st, 2023, Paychex released earnings results for the second quarter of fiscal year 2024 (the company's fiscal year ends May 31st). For the quarter, revenue improved 5.9% to $1.26 billion, but this was $10 million less than expected. Adjusted earnings-per-share of $1.08 compared to $0.99 in the prior year and was $0.01 above estimates.

For the quarter, Management Solutions' revenue grew 4% to $930.7 million due to an increase in the number of clients served as well as better price realization and product penetration. PEO & Insurance Solutions improved 8% to $295.7 million due to a higher number of average employees per worksite and growth in insurance revenue. Interest on funds held for clients grew 44% to $31.5 million. As of the end of the quarter, Paychex held $1.4 billion in cash and equivalents against short-term and long-term borrowings, net of debt issuance costs, of $812 million.

Paychex provided revised guidance for fiscal year 2024 as well. Revenue is still projected to grow 6% to 7% for the fiscal year. Adjusted earnings-per-share is now expected to increase 10% to 11% for the fiscal year, compared to 9% to 11% 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$1.71	$1.85	$2.09	$2.25	$2.45	$2.84	$3.00	$3.04	$3.77	$4.27	***$5.19***	***$7.63***
DPS	$1.40	$1.52	$1.68	$1.84	$2.18	$2.24	$2.48	$2.52	$2.77	$3.26	***$3.56***	***$4.54***
Shares[3]	363	361	360	359	359	359	359	360	361	362	***362***	***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 10.7% 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.

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

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	24.1	24.8	24.0	26.2	25.1	29.6	24.1	33.3	32.8	24.6	***23.1***	***25.0***
Avg. Yld.	3.4%	3.3%	3.4%	3.1%	3.3%	2.7%	3.4%	2.5%	2.2%	3.1%	***3.0%***	***2.4%***

Shares of Paychex have increased $3, or 2.6%, since our September 27th, 2023 report. Based off estimates for earnings-per-share for the current fiscal year, the stock has a P/E ratio of 23.1. For context, shares of Paychex have an average P/E of 26.9 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 2029, then valuation would add 1.6% to annual returns over this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

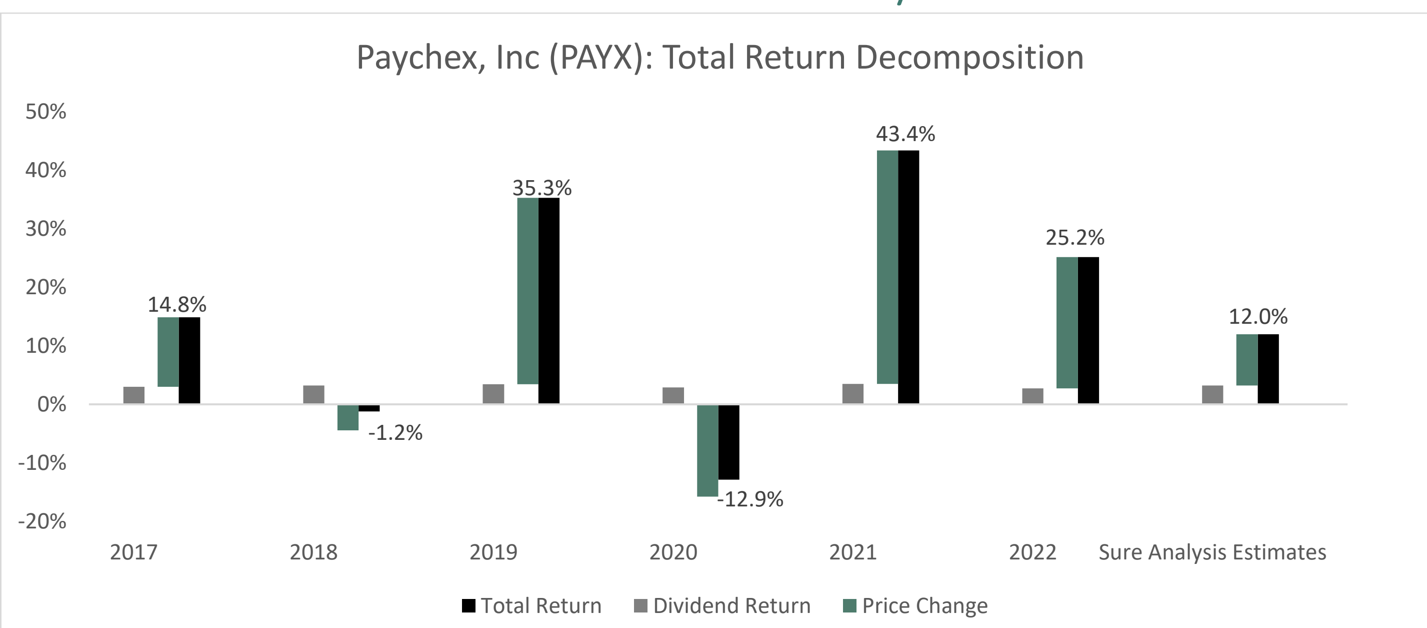
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	82%	82%	80%	82%	82%	79%	83%	82%	73%	76%	***69%***	***60%***

Shares of Paychex were not immune to lower earnings numbers during the last recession. With that said, the company held up 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

After second quarter results, Paychex is now projected to offer a total annual return of 12.0% through fiscal 2029, up from our previous estimate of 10.6%. Our projected return stems from an earnings growth rate of 8%, a starting yield of 3.0%, and a small tailwind from multiple expansion. Paychex continues to produce solid results and the company once again raised guidance for the fiscal year. We have increased our five-year price target $18 to $191 due to revised guidance for the fiscal year. Shares of Paychex continues to receive a buy rating due to projected returns.

Total Return Breakdown by Year



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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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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	2,519	2,740	2,952	3,153	3,378	3,773	4,041	4,057	4,612	5,007
Gross Profit	1,786	1,932	2,095	2,234	2,360	2,595	2,760	2,786	3,255	3,554
Gross Margin	70.9%	70.5%	71.0%	70.8%	69.9%	68.8%	68.3%	68.7%	70.6%	71.0%
SG&A Exp.	804	878	948	980	1,068	1,223	1,299	1,325	1,415	1,521
D&A Exp.	105	107	115	127	138	182	210	192	192	177
Operating Profit	983	1,054	1,147	1,254	1,292	1,371	1,461	1,461	1,840	2,033
Operating Margin	39.0%	38.5%	38.8%	39.8%	38.2%	36.3%	36.1%	36.0%	39.9%	40.6%
Net Profit	628	675	757	826	994	1,034	1,098	1,098	1,393	1,557
Net Margin	24.9%	24.6%	25.6%	26.2%	29.4%	27.4%	27.2%	27.1%	30.2%	31.1%
Free Cash Flow	797	792	921	866	1,122	1,148	1,314	1,146	1,373	1,556
Income Tax	361	385	394	433	306	334	339	337	432	491

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	6,370	6,468	6,441	6,834	7,915	8,676	8,551	9,227	9,635	10,546
Cash & Equivalents	153	170	132	185	358	674	905	995	370	1,222
Accounts Receivable	149	177	409	508	375	421	384	578	724	873
Goodwill & Int. Ass.	581	594	727	715	955	2,182	2,122	2,097	2,056	2,021
Total Liabilities	4,593	4,682	4,529	4,878	5,559	6,057	5,769	6,279	6,550	7,053
Accounts Payable	49	52	57	57	74	76	79	89	106	85
Long-Term Debt	-	-	-	-	-	796	802	805	806	808
Shareholder's Equity	1,777	1,786	1,912	1,955	2,357	2,620	2,781	2,948	3,085	3,493
LTD/E Ratio	-	-	-	-	-	0.30	0.29	0.27	0.26	0.23

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	10.0%	10.5%	11.7%	12.4%	13.5%	12.5%	12.7%	12.3%	14.8%	15.4%
Return on Equity	35.3%	37.9%	40.9%	42.7%	46.1%	41.6%	40.7%	38.3%	46.2%	47.3%
ROIC	35.3%	37.9%	40.9%	42.7%	46.1%	35.8%	31.4%	29.9%	36.4%	38.0%
Shares Out.	363	361	360	359	359	359	359	360	361	362
Revenue/Share	6.88	7.51	8.14	8.70	9.34	10.43	11.19	11.20	12.70	13.82
FCF/Share	2.18	2.17	2.54	2.39	3.10	3.17	3.64	3.16	3.78	4.30

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