

Paychex, Inc.(PAYX)

\$66.60 (As of 05/01/20)

Price Target (6-12 Months): **\$71.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/29/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: D

Growth: C

Momentum: A

Summary

Paychex looks strong on the back of solid top-line growth and dominant position in the outsourcing market. Acquisitions have expanded the company's customer base and generated cost and revenue synergies. Paychex strives to capitalize on the rising opportunities in the professional employer organization industry. The company has been consistently rewarding its shareholders through dividend payout and share repurchases, which boost investors' confidence and positively impact earnings per share. On the flip side, Paychex continues to witness rising expenses due to investment in sales, marketing and product development. PEO insurance costs and acquisitions have also added to the company's costs. Its top-line growth is affected by seasonality. Partly due to these headwinds, the stock has declined significantly over the past year.

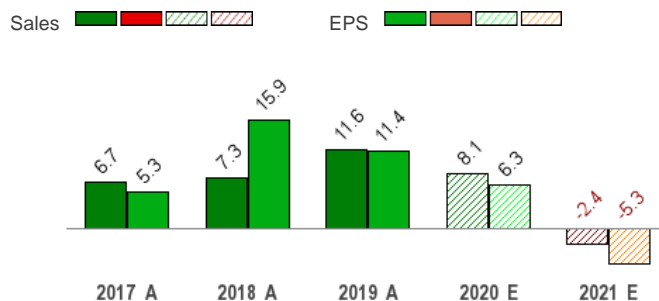
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$90.54 - \$47.87
20 Day Average Volume (sh)	2,703,621
Market Cap	\$23.9 B
YTD Price Change	-21.7%
Beta	0.96
Dividend / Div Yld	\$2.48 / 3.6%
Industry	<u>Outsourcing</u>
Zacks Industry Rank	Top 49% (123 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.1%
Last Sales Surprise	0.5%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	06/24/2020
Earnings ESP	-2.5%
P/E TTM	22.1
P/E F1	22.1
PEG F1	2.5
P/S TTM	5.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	949 E	961 E	1,138 E	988 E	3,981 E
2020	992 A	991 A	1,143 A	958 E	4,080 E
2019	863 A	859 A	1,070 A	980 A	3,773 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.63 E	\$0.64 E	\$0.92 E	\$0.66 E	\$2.86 E
2020	\$0.71 A	\$0.70 A	\$0.97 A	\$0.63 E	\$3.02 E
2019	\$0.67 A	\$0.65 A	\$0.89 A	\$0.63 A	\$2.84 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/01/2020. The reports text is as of 05/04/2020.

Overview

Paychex, Inc. is one of the leading providers of integrated human capital management (“HCM”) solutions for payroll, human resource (“HR”), retirement, and insurance services for small- to medium-sized businesses. The company was incorporated in Delaware in 1979.

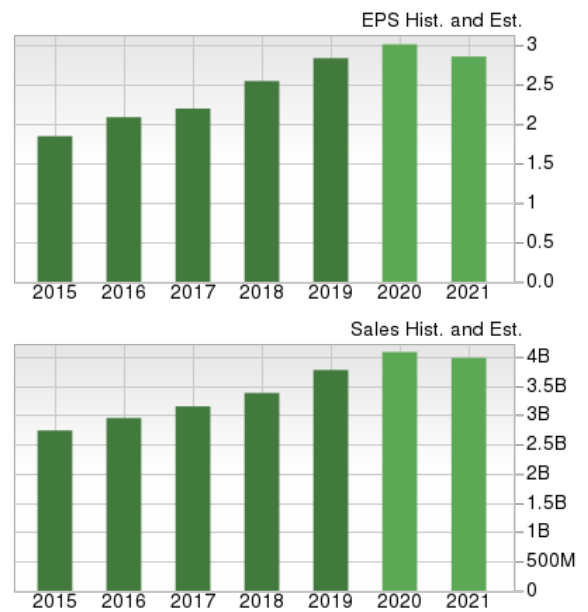
The company's payroll processing services include payroll processing, payroll tax administration services, employee payment services and regulatory compliance services. The company supports small-business companies through its core payroll, software-as-a-service (“SaaS”) Paychex Flex platform, and its SurePayroll® SaaS-based products. The company's SaaS solution through Paychex Flex Enterprise integrates payroll processing with HR management, employee benefits administration, time and labor management, applicant tracking, and onboarding solutions.

The company offers a suite of complementary Human Resource Services (“HRS”) products which include comprehensive HR outsourcing through Paychex HR Services; retirement services administration; insurance services; HR administration services, including time and attendance, benefit enrollment, recruiting, and onboarding; and other HR services and products.

Paychex's wholly owned subsidiary, Paychex Advance LLC (“Paychex Advance”), offers a portfolio of services to the temporary staffing industry. This includes the purchasing of accounts receivable as a means of providing payroll funding to these clients.

As of May 31, 2019, Paychex served more than 670,000 payroll clients (inclusive of the Lessor acquisition). The company maintains its corporate headquarters in Rochester, New York, and serves clients throughout the United States and Europe. The company has one business segment. Its fiscal year ends on May 31.

Paychex operates under two broad categories — Total Service Revenue, and Interest on Funds Held for Clients. In fiscal 2019, Total Service Revenue made up 98% of total revenues and comprised two sub-segments: Management solutions (78% of Total Service Revenue) and professional employer organization (PEO) and insurance services (22% of Total Service Revenue). Interest on Funds Held for Clients accounted for the remaining 2% of fiscal 2019 total revenues.



Reasons To Buy:

- ▲ **Revenue growth** is an important metric for any company as it is a vital part of growth projections and instrumental in strategic decision-making. Also, revenue growth is essential to justify the fixed and variable expenses incurred to operate a business. Paychex has grown meaningfully over the years by providing industry-leading service and technology solutions to its clients and their employees. Its solid business model, diversified products and services, and strategic acquisitions have boosted top-line growth. Notably, revenues grew at 5-year (2014-2019) CAGR of 6.6%. Higher revenues will expand margins and increase profitability in the long run.
- ▲ Paychex's initiatives to boost revenue growth through **acquisitions** are encouraging. During fiscal 2018, Paychex acquired Oasis Outsourcing and Lessor Group. Oasis has strengthened the company's PEO growth strategy, expanded its PEO sales organization and boosted client base. It has expanded Paychex's HR outsourcing and technology-enabled services and is helping it to deliver solid human resources and payroll solutions to clients and employees. Lessor Group is contributing to the company's payroll services. Apart from boosting revenue accretion, acquisitions have historically benefited its operating margin while also resulting in tax synergies.
- ▲ Paychex appears to be striving to capitalize on the rising opportunities in **the PEO** industry. A PEO is a firm or company to which organizations can outsource their HR functions, including payroll and benefits. Therefore, in our opinion, the 2017 acquisition of HR Outsourcing is a strategic fit for Paychex as more and more companies are willing to use PEO services rather than creating their in-house HR. The buyout is expanding the company's services, thereby helping it to add to its customer base.
- ▲ Notably, Paychex's debt-to-capital ratio stood at 25.7 at the end of the third quarter of fiscal 2020, lower than the prior quarter tally of 27X. A low and decreasing debt to capitalization ratio indicates that the company is in a **lesser risk of insolvency**. Further, cash and cash equivalent balance of \$913 million at the end of the quarter was above the long-term debt level of \$902 million, implying that the company has enough cash to meet this debt burden.
- ▲ Paychex puts consistent efforts to reward its shareholders in the form of **dividend and share repurchases**. During the first nine months of fiscal 2020, Paychex repurchased shares worth \$171.9 million and paid dividend of \$666.8 million. In fiscal 2019, Paychex repurchased shares worth \$56.9 million and paid dividend of \$826.8 million. In fiscal 2018, Paychex repurchased shares worth \$143.1 million and paid dividend of \$739.7 million. In fiscal 2017, the company repurchased shares worth \$166.2 million and paid dividends worth \$662.3 million. In fiscal 2016, Paychex bought shares worth \$107.9 million and paid \$606.5 million dividends. These initiatives not only instill investors' confidence but also positively impact earnings per share.

Strength across human resource outsourcing and the PEO industry boosts Paychex.

Reasons To Sell:

- ▼ The outsourcing industry is labor intensive and heavily dependent on foreign talent. **Rising talent costs due to competition** coupled with Trump's stringent policies on immigration could curb the industry's growth. Paychex, being one of the companies in the industry, is likely to get affected.
- ▼ Paychex is seeing **increase in expenses** as it continues to invest in sales, marketing and product development. PEO insurance costs, which include workers' compensation and minimum premium health insurance benefit plans, also adds to the company's expenses. The company's strategic acquisitions, though help in adding revenues and expanding businesses, is another major contributor. Total expenses of \$1.96 billion increased 13% year over year in the first nine months of fiscal 2020. Previously, the company's total expenses increased 15% year over year in fiscal 2019, 10% in fiscal 2018 and 6% in fiscal 2017. Hence, the company's bottom line is likely to remain under pressure going forward. This may weigh on the company's share price, which has declined 21.3% over the past year.
- ▼ Paychex's top line growth/businesses are affected by **seasonality**. During third fiscal quarter (which ends in February), the company witnesses increasing number of new payroll clients, new retirement services clients and new Paychex HR Services worksite employees, compared with the remaining part of the fiscal year. This is because many new clients tend to use company's services at the beginning of a calendar year. Additionally, calendar year-end transaction processing and client funds activity are traditionally higher during the third fiscal quarter due to clients paying year-end bonuses and requesting additional year-end services. Seasonality causes considerable fluctuations in revenues and profits and makes forecasting difficult.

Rising expenses and seasonality are headwinds for Paychex.

Last Earnings Report

Paychex Beats Q3 Earnings & Revenues Estimates

Paychex reported solid third-quarter fiscal 2020 results wherein both earnings and revenues surpassed the Zacks Consensus Estimate.

Adjusted earnings of 97 cents per share outpaced the consensus estimate by 2.1% and increased 9% on a year-over-year basis. Total revenues of \$1.14 billion beat the consensus mark by 0.5% and increased 7% year over year.

The company witnessed solid growth in its human resource ("HR") outsourcing services, time and attendance solutions and retirement services.

During the reported quarter, the company witnessed solid growth across its major business lines. Investments done in both expanding product offerings, like Pay-on-Demand, and technology and mobile app enhancements have been fruitful. Further, the company realized continued momentum in the mid-market space and achieved record-level retention rates across many of its services.

Revenues in Detail

Revenues from Management Solutions increased 6% year over year to \$850 million. Growth was driven by increase in the company's client base and revenue per client, which benefited from higher price realization and increased penetration of its suite of solutions, particularly retirement services, time and attendance, and HR outsourcing.

PEO and insurance services revenues were \$271.5 million, up 10% from the year-ago quarter. The uptick was driven by growth in clients across the company's PEO business. Insurance Services revenue growth was due to rise in the number of health and benefit clients and applicants, partially offset by softness in the workers' compensation market as rates declined.

Furthermore, interest on funds held for clients decreased 7% year over year to \$21.2 million on lower average interest rates earned, which was partially offset by higher average investment balances and realized gains.

Operating Performance

Operating income increased 10% year over year to \$470.1 million. Operating margin rose to 41.1% from 40.1% in the year-ago quarter.

EBITDA of \$520.5 million improved 8% year over year. EBITDA margin came in at 45.6% compared with 45% in the year-ago quarter.

Balance Sheet & Cash Flow

Paychex exited third-quarter fiscal 2020 with cash and cash equivalents of \$780 million compared with \$600.6 million at the end of the prior quarter. Long-term debt came in at \$796.7 million compared with \$796.6 million in the prior quarter. Cash provided by operating activities was \$488.1 million in the reported quarter.

During the reported quarter, the company paid out \$222.5 million in dividends.

Fiscal 2020 View

For fiscal 2020, total revenues are expected to register 8-9% growth. Adjusted earnings per share are anticipated to register nearly 6% growth. Operating margin is expected to be around 36%. EBITDA margin is expected to be nearly 41%.

Paychex expects PEO and insurance services revenues to register nearly 24% growth compared with the prior guided range of 25-30%. Management solutions revenues are anticipated to register around 4% growth compared with the prior guided range of 5-5.5%.

Interest on funds held for clients is anticipated to decline in the range of 2% to 3% compared with the prior guided growth rate of around 4%.

Quarter Ending **02/2020**

Report Date	Mar 25, 2020
Sales Surprise	0.52%
EPS Surprise	2.11%
Quarterly EPS	0.97
Annual EPS (TTM)	3.01

Recent News

On **Mar 30, 2020**, Paychex announced that it is offering the Coronavirus Aid, Relief, and Economic Security (CARES) Act support to help its clients comprehend and implement the act's relevant provisions.

On **Mar 12, 2020**, Paychex announced that it has been honored as one of the top 125 training organizations in the world, for the 19th consecutive year, by Training magazine.

On **Feb 26, 2020**, Paychex announced that it has been honored as one of the World's Most Ethical Companies by Ethisphere for the 12th time.

On **Jan 27, 2020**, Paychex announced that its enhanced Retirement Services Participant Portal has won the 2020 BIG Innovation Awards presented by the Business Intelligence Group.

On **Jan 21, 2020**, Paychex announced that it got listed among FORTUNE magazine's 2020 World's Most Admired Companies.

On **Jan 17, 2020**, Paychex's board of directors declared a regular quarterly dividend of 62 cents per share. The dividend was paid on Feb 20, 2020 to shareholders of record as of Feb 3, 2020.

Valuation

Paychex shares are down 21.7% in the year-to-date period and 21.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Business Services sector are down 16.9% and 7.8% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 18.1% and 11.3%, respectively.

The S&P 500 index is down 12.1% in the year-to-date period and 3.7% in the past year.

The stock is currently trading at 23.19X forward 12-month price-to-earnings, which compares to 19.85X for the Zacks sub-industry, 25.78X for the Zacks sector and 20.18X for the S&P 500 index.

Over the past five years, the stock has traded as high as 30.43X and as low as 15.73X, with a 5-year median of 24.85X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$71.00 price target reflects 24.74X price-to-earnings.

The table below shows summary valuation data for PAYX.

Valuation Multiples - PAYX					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	23.19	19.85	25.78	20.18
	5-Year High	30.43	23.73	25.78	20.18
	5-Year Low	15.73	17.33	18.68	15.19
	5-Year Median	24.85	22.22	20.56	17.44
P/S F12M	Current	5.99	2.41	3.67	3.19
	5-Year High	8.31	2.92	3.94	3.44
	5-Year Low	4.21	2.2	3.05	2.54
	5-Year Median	6.55	2.54	3.57	3.01
P/B TTM	Current	8.66	6.73	4.04	3.75
	5-Year High	12.82	8.73	6.69	4.55
	5-Year Low	6.55	5.14	3.19	2.84
	5-Year Median	10.89	7.2	5.18	3.64

As of 05/01/2020

Industry Analysis Zacks Industry Rank: Top 49% (123 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Broadridge Financial Solutions, Inc. (BR)	Neutral	3
Equifax, Inc. (EFX)	Neutral	4
FactSet Research Systems Inc. (FDS)	Neutral	3
Fidelity National Information Services, Inc. (FIS)	Neutral	3
Fiserv, Inc. (FISV)	Neutral	3
Gartner, Inc. (IT)	Neutral	3
TransUnion (TRU)	Neutral	3
Alliance Data Systems Corporation (ADS)	Underperform	5

Industry Comparison Industry: Outsourcing				Industry Peers		
	PAYX	X Industry	S&P 500	EFX	FIS	FISV
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	3	3
VGM Score	C	-	-	F	D	C
Market Cap	23.89 B	854.11 M	20.61 B	16.74 B	79.87 B	67.80 B
# of Analysts	12	2	14	11	14	15
Dividend Yield	3.72%	0.00%	2.11%	1.13%	1.08%	0.00%
Value Score	D	-	-	F	D	F
Cash/Price	0.04	0.23	0.06	0.02	0.01	0.01
EV/EBITDA	13.81	6.41	11.87	1,249.72	29.83	27.12
PEG Ratio	2.44	1.39	2.47	12.68	1.71	1.61
Price/Book (P/B)	8.66	2.21	2.67	6.89	1.61	1.97
Price/Cash Flow (P/CF)	17.10	7.30	10.66	16.44	16.22	15.39
P/E (F1)	21.99	15.68	19.01	30.93	23.03	22.09
Price/Sales (P/S)	5.82	0.72	2.10	4.62	7.73	6.66
Earnings Yield	4.53%	6.38%	5.05%	3.23%	4.34%	4.53%
Debt/Equity	0.33	0.37	0.72	1.44	0.35	0.62
Cash Flow (\$/share)	4.01	3.07	7.01	8.45	8.13	6.70
Growth Score	C	-	-	F	D	A
Hist. EPS Growth (3-5 yrs)	10.95%	11.51%	10.88%	5.44%	18.44%	17.05%
Proj. EPS Growth (F1/F0)	6.19%	5.65%	-7.32%	-20.67%	0.06%	13.47%
Curr. Cash Flow Growth	10.82%	12.88%	5.92%	0.48%	57.47%	147.85%
Hist. Cash Flow Growth (3-5 yrs)	12.37%	12.37%	8.55%	8.37%	26.53%	29.38%
Current Ratio	1.19	1.24	1.23	1.00	0.84	1.08
Debt/Capital	24.63%	28.54%	43.84%	59.06%	25.84%	38.74%
Net Margin	26.98%	1.94%	11.08%	7.45%	2.88%	8.77%
Return on Equity	41.68%	16.61%	16.44%	27.87%	9.60%	11.78%
Sales/Assets	0.46	1.07	0.54	0.48	0.18	0.22
Proj. Sales Growth (F1/F0)	8.15%	2.97%	-1.42%	-2.13%	20.54%	41.57%
Momentum Score	A	-	-	D	C	C
Daily Price Chg	-1.92%	-2.66%	-2.39%	-3.21%	-1.79%	-1.59%
1 Week Price Chg	0.87%	-0.61%	-1.74%	2.70%	-1.74%	-4.31%
4 Week Price Chg	12.27%	16.60%	17.07%	27.07%	12.62%	16.12%
12 Week Price Chg	-22.53%	-23.39%	-18.53%	-10.94%	-10.49%	-15.30%
52 Week Price Chg	-17.23%	-30.06%	-9.82%	12.65%	11.96%	20.59%
20 Day Average Volume	2,703,621	361,461	2,641,413	1,002,162	4,048,243	4,003,916
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.87%
(F1) EPS Est 4 week change	-0.19%	-5.36%	-6.62%	-20.36%	-8.34%	-6.25%
(F1) EPS Est 12 week change	-2.92%	-9.76%	-13.28%	-22.64%	-11.14%	-8.44%
(Q1) EPS Est Mthly Chg	-0.29%	-3.43%	-11.97%	-37.19%	-17.07%	-10.79%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	C
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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