

Paychex, Inc.(PAYX)

\$89.65 (As of 01/23/20)

Price Target (6-12 Months): **\$95.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/29/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: D

Summary

Paychex reported better-than-expected second-quarter fiscal 2020 results. The company looks strong on the back of solid top-line growth and dominant position in the outsourcing market. Buyouts 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 payment and share repurchases, which boost investors' confidence and positively impact earnings per share. This might have impacted the stock, which has outperformed its industry year. However, Paychex continues to witness rising expenses due to PEO insurance costs and investment in sales, marketing and product development. The company's top-line growth is affected by seasonality.

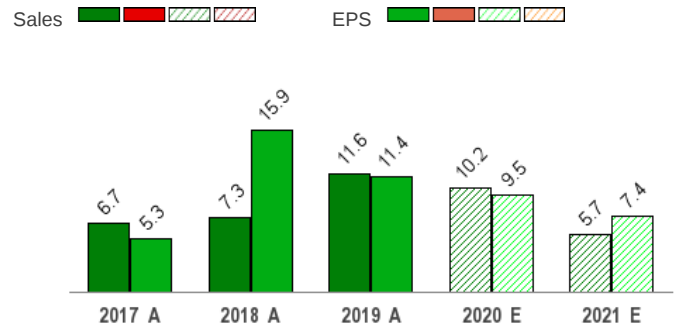
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$89.96 - \$69.40
20 Day Average Volume (sh)	1,188,936
Market Cap	\$32.1 B
YTD Price Change	5.4%
Beta	0.87
Dividend / Div Yld	\$2.48 / 2.8%
Industry	<u>Outsourcing</u>
Zacks Industry Rank	Bottom 33% (171 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.9%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/25/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,047 E	1,045 E	1,205 E	1,098 E	4,391 E
2020	992 A	991 A	1,137 E	1,037 E	4,156 E
2019	863 A	859 A	1,070 A	980 A	3,773 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.77 E	\$0.76 E	\$1.03 E	\$0.79 E	\$3.34 E
2020	\$0.71 A	\$0.70 A	\$0.95 E	\$0.73 E	\$3.11 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.

P/E TTM	30.6
P/E F1	28.8
PEG F1	3.2
P/S TTM	8.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/23/2020. The reports text is as of 01/24/2020.

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.

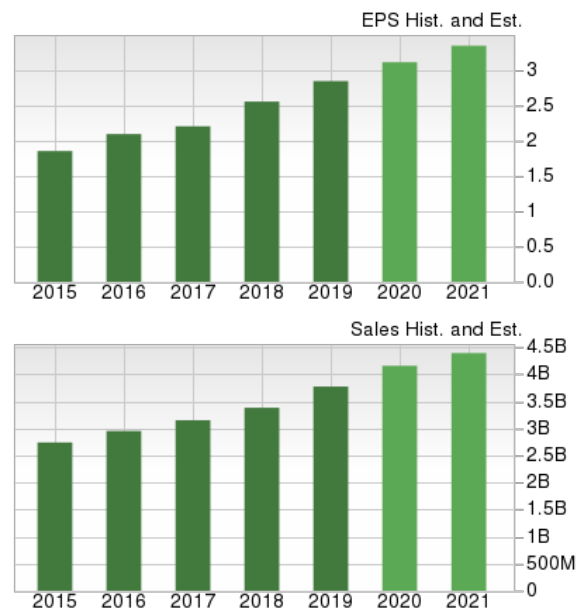
The company's payroll processing services include payroll processing, payroll tax administration services, employee payment services and regulatory compliance services. The company supports small-business companies through its core payroll, software-as-a-service ("SaaS") Paychex Flex platform, and its 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, 2018, Paychex served more than 650,000 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.
- ▲ Paychex puts consistent efforts to reward its shareholders in the form of **dividend and share repurchases**. During the first half of fiscal 2020, Paychex repurchased shares worth \$171.9 million and paid dividend of \$444.3 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. This might have impacted the company's share price, which has improved 31.2% year to date, outperforming the 29.2% rise of the industry it belongs to.

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 \$1.29 billion increased 18% year over year in the first half 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.
 - ▼ 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.
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Rising expenses and seasonality are headwinds for Paychex.

Last Earnings Report

Paychex Earnings & Revenues Beat Estimates in Q2

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

Adjusted earnings of 70 cents per share outpaced the consensus estimate by 2.9% and increased 8% on a year-over-year basis. Total revenues of \$990.7 billion beat the consensus mark by 0.4% and increased 15% year over year.

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

Quarter Ending **11/2019**

Report Date	Dec 18, 2019
Sales Surprise	0.43%
EPS Surprise	2.94%
Quarterly EPS	0.70
Annual EPS (TTM)	2.93

Revenues in Detail

Revenues from Management Solutions increased 6% year over year to \$726.7 million. Growth was driven by increase in the company's client base and revenue per client. Under Management Solutions, retirement services' revenues benefited from an increase in the asset fee revenues earned on the asset value of participants' funds.

PEO and insurance services revenues were \$244.1 million, up 57% from the year-ago quarter. The uptick was driven by contribution from Oasis acquisition and growth in clients and client worksite employees 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 state insurance fund rates declined.

Furthermore, interest on funds held for clients increased 9% year over year to \$19.9 million on higher realized gains, average investment balances and average interest rates.

Operating Performance

Operating income increased 11% year over year to \$341.7 million. However, operating income margin declined to 34.5% from 35.8% in the year-ago quarter. EBITDA of \$398.8 million improved 16% year over year. EBITDA margin of 40% was flat year over year.

Balance Sheet & Cash Flow

Paychex exited second-quarter fiscal 2020 with cash and cash equivalents of \$600.6 million compared with \$586.4 million at the end of the prior quarter. Long-term debt of \$796.6 million was flat year over year. Cash provided by operating activities was \$269.8 million in the reported quarter. During the reported quarter, the company paid out \$222 million in dividends.

Fiscal 2020 View

For fiscal 2020, Paychex expects PEO and insurance services revenues to register 25-30% growth compared with the prior guided growth rate of 30%. Management solutions revenues are anticipated to register 5-5.5% growth compared with the prior guided growth rate of 5%.

Recent News

On **Jan 17, 2019**, Paychex's board of directors declared a regular quarterly dividend of 62 cents per share. The dividend is payable on Feb 20, 2020 to shareholders of record as of Feb 3, 2020.

On **Oct 17, 2019**, Paychex's board of directors declared a regular quarterly dividend of 62 cents per share. The dividend is payable on Nov 21, 2019 to shareholders of record as of Nov 1, 2019.

Valuation

Paychex shares are up 31.2% over the trailing 12-month period. The Zacks sub-industry, sector and S&P 500 index are up 29.2%, 30.1% and 26.7%, respectively in the same time frame.

The stock is currently trading at 27.51X forward 12-month price-to-earnings, which compares to 23.52X for the Zacks sub-industry, 26.13X for the Zacks sector and 19.13X for the S&P 500 index.

Over the past five years, the stock has traded as high as 30.43X and as low as 20.74X, with a 5-year median of 24.86X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$95.00 price target reflects 29.14X 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	27.51	23.52	26.13	19.13
	5-Year High	30.43	23.76	26.13	19.34
	5-Year Low	20.74	18.79	18.76	15.17
	5-Year Median	24.86	22.41	20.56	17.44
P/S F12M	Current	4.93	3.05	4.15	3.56
	5-Year High	5.11	3.05	5.13	3.56
	5-Year Low	2.86	2.23	3.09	2.54
	5-Year Median	3.61	2.55	3.63	3
P/B TTM	Current	12.49	8.57	5.11	4.5
	5-Year High	12.82	8.69	6.71	4.55
	5-Year Low	8.73	5.73	4.13	2.85
	5-Year Median	10.84	7.17	5.31	3.61

As of 01/23/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (171 out of 255)



Top Peers

Alliance Data Systems Corporation (ADS)	Neutral
Broadridge Financial Solutions, Inc. (BR)	Neutral
Equifax, Inc. (EFX)	Neutral
FactSet Research Systems Inc. (FDS)	Neutral
Fidelity National Information Services, Inc. (FIS)	Neutral
Fiserv, Inc. (FISV)	Neutral
Gartner, Inc. (IT)	Neutral
TransUnion (TRU)	Neutral

Industry Comparison Industry: Outsourcing				Industry Peers		
	PAYX Neutral	X Industry	S&P 500	EFX Neutral	FIS Neutral	FISV Neutral
VGM Score	D	-	-	F	D	C
Market Cap	32.09 B	1.30 B	24.46 B	18.76 B	91.58 B	83.10 B
# of Analysts	11	2	13	11	13	13
Dividend Yield	2.77%	0.00%	1.75%	1.01%	0.94%	0.00%
Value Score	D	-	-	D	D	D
Cash/Price	0.02	0.10	0.04	0.01	0.01	0.01
EV/EBITDA	18.16	11.54	14.11	27.63	37.56	45.23
PEG Ratio	3.21	1.64	2.04	3.11	2.64	1.78
Price/Book (P/B)	12.49	3.65	3.40	7.33	1.86	2.46
Price/Cash Flow (P/CF)	22.38	14.35	13.66	18.35	15.38	26.51
P/E (F1)	28.85	19.51	19.10	26.89	23.61	24.66
Price/Sales (P/S)	7.96	1.00	2.67	5.46	10.00	10.80
Earnings Yield	3.47%	5.12%	5.23%	3.72%	4.23%	4.06%
Debt/Equity	0.35	0.35	0.72	1.11	0.34	0.66
Cash Flow (\$/share)	4.01	3.29	6.94	8.44	9.69	4.61
Growth Score	C	-	-	F	C	B
Hist. EPS Growth (3-5 yrs)	10.85%	12.28%	10.60%	8.15%	17.58%	16.43%
Proj. EPS Growth (F1/F0)	9.41%	12.94%	7.59%	3.29%	14.62%	23.71%
Curr. Cash Flow Growth	10.82%	10.68%	13.90%	0.23%	10.67%	18.73%
Hist. Cash Flow Growth (3-5 yrs)	12.37%	11.79%	9.00%	9.86%	16.71%	8.93%
Current Ratio	1.17	1.24	1.22	0.57	0.86	1.08
Debt/Capital	25.87%	28.68%	42.99%	52.56%	25.61%	39.69%
Net Margin	26.72%	1.67%	11.35%	-11.13%	8.24%	12.11%
Return on Equity	41.21%	14.59%	17.10%	24.39%	12.07%	16.73%
Sales/Assets	0.44	1.10	0.55	0.47	0.22	0.26
Proj. Sales Growth (F1/F0)	10.17%	6.06%	4.03%	5.68%	27.54%	6.99%
Momentum Score	D	-	-	F	D	B
Daily Price Chg	0.06%	0.27%	0.26%	0.13%	0.28%	0.15%
1 Week Price Chg	3.48%	2.63%	2.29%	4.30%	3.63%	3.03%
4 Week Price Chg	5.83%	0.00%	2.24%	10.51%	7.43%	5.34%
12 Week Price Chg	7.19%	6.61%	7.79%	13.34%	13.09%	15.16%
52 Week Price Chg	28.77%	19.70%	21.61%	49.25%	41.70%	47.64%
20 Day Average Volume	1,188,936	135,932	1,536,379	601,052	2,674,881	2,404,412
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.28%	0.16%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.31%	0.16%	0.18%
(F1) EPS Est 12 week change	0.01%	0.00%	-0.23%	-1.44%	0.98%	2.84%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-0.24%	0.00%

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	D
VGM Score	D

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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