

Paychex

Uneventful kick-off to F24; Maintain Underperform

Reiterate Rating: UNDERPERFORM | PO: 106.00 USD | Price: 117.35 USD

No surprises in print, SMBs hanging in for now

PAYX is outperforming today after reporting a slight beat/raise. With estimates unlikely to move materially, we are somewhat surprised by the magnitude of the move, but acknowledge that shares had been somewhat weak since the IRS announcement on 9/14 regarding a pause in processing of ERTC claims. Management suggested this announcement will not have a material impact, as ERTC claims are still being submitted. Overall, the print doesn't change our thesis; reiterate Underperform as unemployment will likely continue to rise while rates are approaching a peak and valuation remains high.

Steady macro backdrop

Management suggested the macro backdrop has remained stable for SMBs, though the pace of hiring and wage inflation has moderated. F1Q sales grew double-digits, with solid performance in Management Solutions and PEO. That said, PAYX's key selling season and the open enrollment period still loom ahead. PAYX believes that corrective actions in PEO segment are seeing some traction, with encouraging retention metrics.

F24 EPS guidance ticked up slightly

PAYX tweaked the upper end of its F24 Adj EPS growth guidance to 9%-11% from 9%-10%. PAYX now expects total revenue growth to be at the upper end of its prior outlook (6%-7%) and anticipates F1H/F2H growth of 6-7%/7%, respectively. F24 operating margin guide of 41-42% was unchanged, with F1H/F2H forecast at 40%-41%/42%-43% (2H higher due to seasonality, opex timing). F24 guide for interest on funds held for clients was raised \$5M to \$140M-\$150M.

ERTC: processing halted, still minor headwind in F2H

PAYX shares lagged on 9/14 after the IRS announced it was halting ERTC processing due to high levels of suspected fraud. ERTC contributed 1%-2% of PAYX's total revenues in F23, and management had previously guided to that contribution shrinking in F24. PAYX does not think the pause will impact PAYX's ability to assist in filing for the tax credit, but still expects ERTC to turn from a tailwind in F1H to a headwind in F2H.

More on F1Q24 inside; raise PO slightly to \$106

Estimates (May) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	3.77	4.27	4.70	4.95	5.23
GAAP EPS	3.84	4.30	4.71	4.95	5.23
EPS Change (YoY)	24.0%	13.3%	10.1%	5.3%	5.7%
Consensus EPS (Bloomberg)			4.68	5.00	NA
DPS	2.77	3.26	3.56	3.56	3.56
Valuation (May)					
P/E	31.1x	27.5x	25.0x	23.7x	22.4x
GAAP P/E	30.6x	27.3x	24.9x	23.7x	22.4x
Dividend Yield	2.4%	2.8%	3.0%	3.0%	3.0%
EV / EBITDA*	21.2x	19.2x	17.5x	16.8x	15.9x
Free Cash Flow Yield*	3.2%	3.7%	5.1%	4.7%	5.2%

* For full definitions of *IQmethod*SM measures, see page 6.

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Timestamp: 27 September 2023 01:24PM EDT

27 September 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	103.00	106.00
2024E Rev (m)	5324.4	5349.4
2025E Rev (m)	5641.9	5660.3
2026E Rev (m)	5917.5	5936.9
2024E EPS	4.67	4.70
2026E EPS	5.22	5.23

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Stock Data

Price	117.35 USD
Price Objective	106.00 USD
Date Established	27-Sep-2023
Investment Opinion	B-3-7
52-Week Range	104.09 USD - 129.70 USD
Mkt Val (mn) / Shares Out (mn)	42,340 USD / 360.8
Average Daily Value (mn)	181.91 USD
BofA Ticker / Exchange	PAYX / NAS
Bloomberg / Reuters	PAYX US / PAYX.OQ
ROE (2024E)	45.4%
Net Dbt to Eqty (May-2023A)	-35.0%
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

ERTC - Employee retention tax credit
SMB - small/medium sized businesses

iQprofileSM Paychex

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	27.1%	28.3%	29.0%	28.1%	27.0%
Return on Equity	45.3%	47.1%	45.4%	41.1%	37.2%
Operating Margin	39.9%	40.6%	41.8%	41.7%	42.2%
Free Cash Flow	1,373	1,556	2,140	1,983	2,199

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.1x	1.1x	1.3x	1.2x	1.3x
Asset Replacement Ratio	0.7x	0.8x	1.0x	1.0x	1.1x
Tax Rate	23.7%	24.0%	24.4%	24.5%	24.5%
Net Debt-to-Equity Ratio	-12.0%	-35.0%	-43.1%	-45.2%	-49.8%
Interest Cover	NM	NA	NA	NA	NA

Income Statement Data (May)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	4,612	5,007	5,349	5,660	5,937
% Change	13.7%	8.6%	6.8%	5.8%	4.9%
Gross Profit	3,255	3,554	3,812	4,036	4,245
% Change	16.9%	9.2%	7.3%	5.9%	5.2%
EBITDA	2,016	2,225	2,432	2,545	2,684
% Change	24.0%	10.3%	9.3%	4.7%	5.4%
Net Interest & Other Income	(15)	15	34	20	10
Net Income (Adjusted)	1,368	1,548	1,709	1,797	1,900
% Change	24.1%	13.2%	10.4%	5.2%	5.7%

Free Cash Flow Data (May)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	1,393	1,557	1,713	1,797	1,900
Depreciation & Amortization	192	177	165	165	168
Change in Working Capital	(368)	(318)	305	128	245
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	289	283	118	62	64
Capital Expenditure	(133)	(143)	(161)	(170)	(178)
Free Cash Flow	1,373	1,556	2,140	1,983	2,199
% Change	19.8%	13.4%	37.5%	-7.3%	10.9%

Balance Sheet Data (May)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	370	1,222	1,740	2,130	2,732
Trade Receivables	1,296	1,402	1,488	1,578	1,662
Other Current Assets	1,233	786	500	606	712
Property, Plant & Equipment	401	396	403	409	419
Other Non-Current Assets	6,335	6,741	7,403	7,647	7,895
Total Assets	9,635	10,546	11,534	12,370	13,420
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	4,360	4,832	5,419	5,680	6,056
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	2,190	2,222	2,075	1,976	1,877
Total Liabilities	6,550	7,053	7,494	7,656	7,933
Total Equity	3,085	3,493	4,041	4,714	5,487
Total Equity & Liabilities	9,635	10,546	11,534	12,370	13,420

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Payments, Processors & IT Services

Company Description

PAYX is the second-largest provider of payroll, human resources, and benefits outsourcing solutions in the US. Clients are primarily small- to medium-sized businesses. The company offers comprehensive payroll services, including payroll processing, payroll tax administration, and employee pay services. It also provides HR solutions, such as 401(k) and retirement services.

Investment Rationale

We rate PAYX Underperform. We view PAYX's robust profitability and solid balance sheet / cash-flow profile favorably, however, we think the risk of rising unemployment, higher rates, and weakness for SMBs are not properly reflected in current valuation.

Stock Data

Average Daily Volume

1,550,145

Quarterly Earnings Estimates

	2023	2024
Q1	1.03A	1.14A
Q2	0.99A	1.06E
Q3	1.29A	1.34E
Q4	0.97A	1.16E

Tweak estimates, raise PO to \$106

Following the print, we increase our F24 EPS estimate to \$4.70 from \$4.67, leave F25 unchanged at \$4.95, and raise F26 to \$5.23 from \$5.22. We slightly raise our PO to \$106 from \$103 based on a 50/50 blend of 23x (unchanged) our C24 Adj EPS estimate and our DCF (WACC is now 9.5% vs 9.0% prior).

Updated F24 guidance; largely unchanged vs initial guide

Exhibit 1: PAYX F24 updated guidance

F24 updated guide vs Street/BofA ests

	Prior F24 guidance	New F24 guidance	Street ests	BofAe (old)	BofAe (new)
Management Solutions	5% - 6%	5% - 6%	5.5%	5.4%	5.5%
PEO and Insurance Solutions	6% - 9%	6% - 9%	6.7%	6.7%	7.6%
Total Revenue	6% - 7%	6% - 7%	6.4%	6.3%	6.8%
Adj. Diluted EPS	9% - 10%	9% - 11%	9.6%	9.2%	10.0%
Interest on Funds held for client	\$135M - \$145M	\$140M - \$150M	\$141M	\$138M	\$146M
Adj. Operating Income as % of Total Rev	41% - 42%	41% - 42%	41.5%	41.5%	41.8%
Other Income, net	\$30M - \$35M	\$30M - \$35M	\$33M	\$32M	\$34M
Effective Income tax rate	24% - 25%	24% - 25%	24.4%	24.5%	24.4%

Source: Company reports, BofA Global Research estimates

BofA GLOBAL RESEARCH

F1Q results

- Total revenue of \$1,286M ahead of BofA/Street ests of \$1,285M/\$1,283M
 - Management Solutions revenues of \$956M, ahead of BofA/Street ests of \$958M/\$955M
 - PEO/Insurance revs of \$298M, ahead of BofA/Street ests of \$294M/\$296M
 - Interest on Client funds of \$33M in line with BofA/Street ests of \$33M/\$33M
- Operating margin of 41.7% vs BofA/Street at 41.3%/\$41.1%
- Adj EPS of \$1.14, ahead of BofA/Street at \$1.12/\$1.12



Price objective basis & risk

Paychex (PAYX)

Our \$106 PO is based on a 50/50 combination of a 23x PE multiple to our CY24E EPS and our discounted cash flow (DCF) model. A 23x PE multiple is an approximately 20% premium to the S&P 500, which is below PAYX's 10-yr average premium of about 50%. We think this correctly reflects PAYX's operating momentum, coupled with elevated risks of rising unemployment, higher rates, and weakness in the SMB market. Our DCF uses a 3% terminal rate and a 9.5% WACC.

Downside risks to our price objective are 1) slower new business formation, 2) declines in US employment, and 3) greater competition from payroll software firms, which puts pressure on pricing.

Upside risks to our price objective are 1) faster new business formation and 2) strong US employment growth.

Analyst Certification

I, Jason Kupferberg, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Payments, Processors, Specialty Finance and IT services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Accenture Plc	ACN	ACN US	Jason Kupferberg
	American Express Company	AXP	AXP US	Mihir Bhatia
	Ares Capital Corporation	ARCC	ARCC US	Derek Hewett
	Ares Commercial Real Estate Corporation	ACRE	ACRE US	Derek Hewett
	Baring's BDC Inc	BBDC	BBDC US	Derek Hewett
	Blackrock TCP Capital Corp	TCPC	TCPC US	Derek Hewett
	Blackstone Mortgage Trust Inc	BXMT	BXMT US	Derek Hewett
	Block Inc	SQ	SQ US	Jason Kupferberg
	Blue Owl Capital Corporation	OBDC	OBDC US	Derek Hewett
	Bread Financial Holdings Inc	BFH	BFH US	Mihir Bhatia
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	EngageSmart	ESMT	ESMT US	Jason Kupferberg
	Essent Group	ESNT	ESNT US	Mihir Bhatia
	Fidelity National Information Services	FIS	FIS US	Jason Kupferberg
	Fiserv Inc	FI	FI US	Jason Kupferberg
	FleetCor Technologies Inc.	FLT	FLT US	Mihir Bhatia
	Flywire	FLYW	FLYW US	Jason Kupferberg
	Global Payments Inc	GPV	GPV US	Jason Kupferberg
	Mastercard Inc	MA	MA US	Jason Kupferberg
	MGIC Investment Corp.	MTG	MTG US	Mihir Bhatia
	New Mountain Finance Corporation	NMFC	NMFC US	Derek Hewett
	Nuvei	NVEI	NVEI US	Jason Kupferberg
	Nuvei	YNVEI	NVEI CN	Jason Kupferberg
	OneMain Holdings, Inc.	OMF	OMF US	Mihir Bhatia
	PayPal Holdings Inc	PYPL	PYPL US	Jason Kupferberg
	Safhold, Inc	SAFE	SAFE US	Derek Hewett
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Sixth Street Specialty Lending, Inc	TSLX	TSLX US	Derek Hewett
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	Telus International	TIXT	TIXT US	Cassie Chan
	Telus International	YTIXT	TIXT CN	Cassie Chan
	Toast	TOST	TOST US	Jason Kupferberg
	Visa Inc.	V	V US	Jason Kupferberg

US - Payments, Processors, Specialty Finance and IT services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	WEX Inc.	WEX	WEX US	Mihir Bhatia
NEUTRAL				
	Affirm Holdings	AFRM	AFRM US	Jason Kupferberg
	AGNC Investment Corp	AGNC	AGNC US	Derek Hewett
	Annaly Capital Management	NLY	NLY US	Derek Hewett
	Apollo Commercial Real Estate Finance	ARI	ARI US	Derek Hewett
	Bain Capital Specialty Finance, Inc.	BCSF	BCSF US	Derek Hewett
	Blackstone Secured Lending Fund	BXSL	BXSL US	Derek Hewett
	BrightSpire Capital Inc.	BRSP	BRSP US	Derek Hewett
	Capital One Financial	COF	COF US	Mihir Bhatia
	Discover Financial	DFS	DFS US	Mihir Bhatia
	DLocal	DLO	DLO US	Jason Kupferberg
	Ellington Financial	EFC	EFC US	Derek Hewett
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Jack Henry & Associates	JKHY	JKHY US	Jason Kupferberg
	Ladder Capital Corp	LADR	LADR US	Derek Hewett
	Marqeta	MQ	MQ US	Jason Kupferberg
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	SoFi Technologies Inc	SOFI	SOFI US	Mihir Bhatia
	Synchrony Financial	SYF	SYF US	Mihir Bhatia
	Thoughtworks	TWKS	TWKS US	Jason Kupferberg
	TPG RE Finance Trust, Inc.	TRTX	TRTX US	Derek Hewett
	TTEC Holdings	TTEC	TTEC US	Cassie Chan
UNDERPERFORM				
	ADP	ADP	ADP US	Jason Kupferberg
	Angel Oak Mortgage Inc.	AOMR	AOMR US	Derek Hewett
	CGI Inc.	GIB	GIB US	Jason Kupferberg
	CGI Inc.	YGIBA	GIB/A CN	Jason Kupferberg
	Cognizant Technology Solutions	CTSH	CTSH US	Jason Kupferberg
	Coinbase	COIN	COIN US	Jason Kupferberg
	DXC Technology	DXC	DXC US	Jason Kupferberg
	EPAM Systems	EPAM	EPAM US	Jason Kupferberg
	Guild Holdings Company	GHLD	GHLD US	Derek Hewett
	Invesco Mortgage Capital, Inc.	IVR	IVR US	Derek Hewett
	loanDepot Inc	LDI	LDI US	Derek Hewett
	MidCap Financial Investment Co	MFIC	MFIC US	Derek Hewett
	New York Mortgage Trust	NYMT	NYMT US	Derek Hewett
	Paychex	PAYX	PAYX US	Jason Kupferberg
	Radian Group Inc	RDN	RDN US	Mihir Bhatia
	Rocket Companies, Inc.	RKT	RKT US	Mihir Bhatia
	TaskUs	TASK	TASK US	Cassie Chan
	Western Union	WU	WU US	Jason Kupferberg



IQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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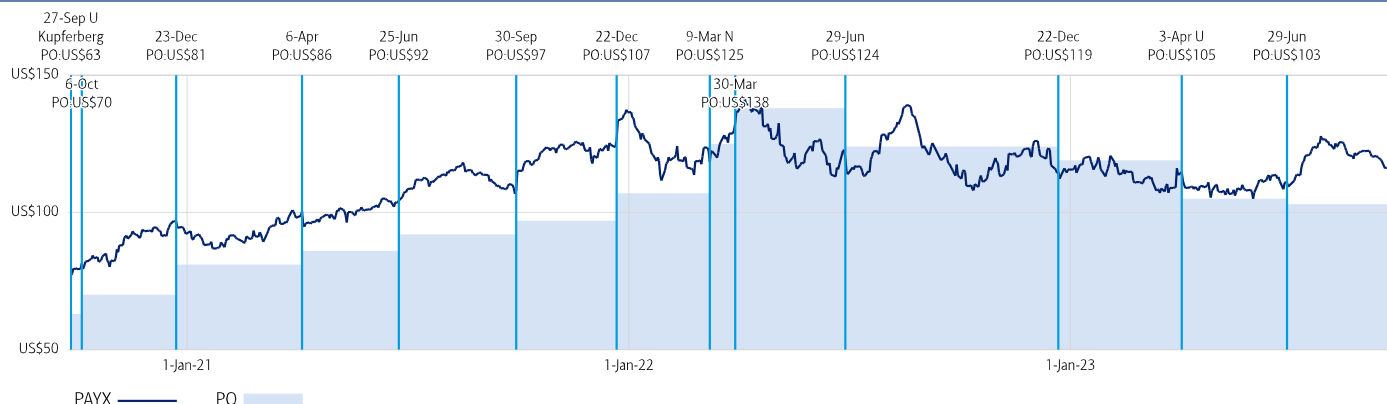
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Disclosures

Important Disclosures

Paychex (PAYX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Technology Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	212	53.13%	Buy	103	48.58%
Hold	89	22.31%	Hold	45	50.56%
Sell	98	24.56%	Sell	30	30.61%

Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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