Paychex

Takeaways from CEO/CFO meetings

Maintain Rating: UNDERPERFORM | PO: 105.00 USD | Price: 121.36 USD

30 January 2024

Equity

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Poised for the post-pandemic era

Yesterday, we hosted investor meetings in NYC with Paychex's (PAYX) CEO and CFO. The company believes that its post-pandemic era has now officially started. Overall, management struck an optimistic tone with respect to structural trends driving the company's medium-term top and bottom-line growth targets. We believe PAYX has a sturdy long-term business model, and our Underperform rating continues to be based on cyclical factors, as tailwinds of employment and rates lose steam, as well as valuation.

Remaining confident in medium-term targets

PAYX targets medium-term revs growth of upper single digits, with EPS growth of upper single digits to low double-digits. In a typical year, the client base should grow 1-3%, as PAYX continues taking share from in-house and small regional payroll providers (still ~45% of the market) due to PAYX's superior value proposition for SMBs, while the digital economy promotes healthy levels of new business creation. Revenue growth is augmented by increased attach rates for ancillary products such as HR Outsourcing, retirement, and insurance. PAYX targets annual price increases of 2-4%. By segment, we believe Management Solutions (MS) can grow roughly mid-single digits, with the PEO/Insurance segment growing faster (PEO industry has grown ~8% over time).

Management reiterated Dec. earnings call commentary

PAYX did not make any specific comments about January trends amid the key selling season. However, management reiterated commentary from the last earnings call on 12/21/23, suggesting robust pipeline and retention trends. PAYX continues to expect F2H24 MS growth to be steady vs. F1H at 5% - while the lapping of benefits from the Employee Retention Tax Credit (ERTC) program is a headwind (peaking in F3Q), this is offset by easier underlying compares, ongoing strength from ancillaries (ie, retirement), and a little bit of pricing and incremental M&A contribution.

Initial F25 guide coming in March + other takeaways

1) PAYX will provide preliminary F25 guidance on the March call - ERTC will remain a headwind in F1H25, and potential Fed rate cuts may have to be factored into float + corporate interest income (though lower rates would be positive for SMB growth), 2) mgmt remains committed to ongoing margin improvement, with more emphasis on margin $ than margin %, 3) M&A is of interest and valuations have become somewhat more rational, but return hurdles are high and dividend remains top capital deployment priority, 4) in addition to typical annual list price increases, PAYX drives price realization by managing the scope and duration of discounts, 5) PAYX is using AI to enhance sales, customer service, pricing, and product, 6) while uncontrollable client losses (ie, bankruptcies) are up, controllable losses are down (competitive intensity is stable), 7) PAYX is focused on continuing to encourage ASO clients to migrate to PEO, which carries 2x customer lifetime value (but can shift revenue at the segment level from MS to PEO), and 8) since the pandemic PAYX's go-to-market model has structurally migrated to more of a virtual approach from in-person.

Stock Data

Price	121.36 USD
Price Objective	105.00 USD
Date Established	21-Dec-2023
Investment Opinion	B-3-7
52-Week Range	104.09 USD - 129.70 USD
Mrkt Val (mn) / Shares Out (mn)	43,787 USD / 360.8
Free Float	89.3%
Average Daily Value (mn)	249.35 USD
BofA Ticker / Exchange	PAYX / NAS
Bloomberg / Reuters	PAYX US / PAYX.OQ
ROE (2024E)	48.6%
Net Dbt to Eqty (May-2023A)	-35.0%
ESGMeter™	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".

ASO = Administrative Services Organization

PEO = Professional Employer Organization

SMB = small and medium sized businesses

Refer to important disclosures on page 3 to 5. Analyst Certification on page 2. Price Objective Basis/Risk on page 2.

Price objective basis & risk

Paychex (PAYX)

Our $105 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.

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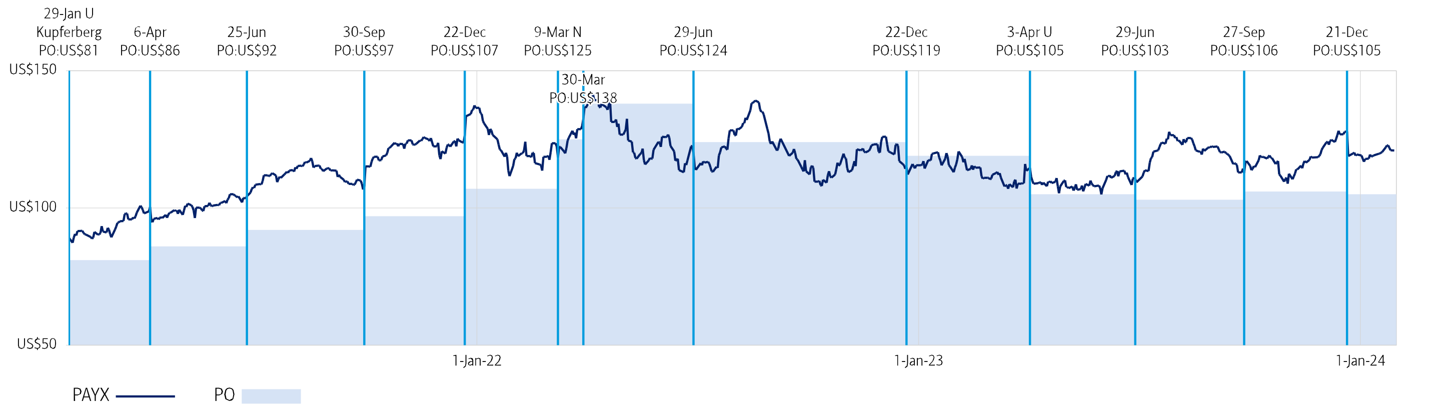
Important Disclosures

Paychex (PAYX) Price Chart



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

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Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Buy	≥ 10%	≤ 70%
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