

Paychex, Inc. Reports First Quarter Results

October 2, 2019

First Quarter Fiscal 2020 Highlights

- Total revenue increased 15% to \$992.0 million.
- Operating income increased 9% to \$349.1 million.
- Net income increased 8% to \$264.2 million and adjusted net income⁽¹⁾ increased 6% to \$257.6 million.
- Diluted earnings per share increased 9% to \$0.73 per share and adjusted diluted earnings per share⁽¹⁾ increased 6% to \$0.71 per share.
- Earnings before interest, taxes, depreciation and amortization (“EBITDA”)⁽¹⁾ increased 13% to \$403.0 million.

⁽¹⁾ Adjusted net income, adjusted diluted earnings per share, and EBITDA are not United States (“U.S.”) generally accepted accounting principles (“GAAP”) measures. Please refer to the “Non-GAAP Financial Measures” section on page 4 of this press release for a discussion of these non-GAAP measures and a reconciliation to the most comparable U.S. GAAP measures of net income and diluted earnings per share.

Rochester, N.Y., (October 2, 2019) — Paychex, Inc. (“Paychex,” “we,” “our,” or “us”) (Nasdaq:PAYX) today announced total revenue of \$992.0 million for the three months ended August 31, 2019 (the “first quarter”), an increase of 15% from \$862.8 million for the same period last year. Oasis Outsourcing Group Holdings, L.P. (“Oasis”), acquired during December 2018, contributed a little less than 10% to the growth in total revenue compared to the same period last year. Net income increased 8% to \$264.2 million and diluted earnings per share increased 9% to \$0.73 per share for the first quarter. Adjusted net income and adjusted diluted earnings per share, both non-GAAP measures, each increased 6% to \$257.6 million and \$0.71 per share, respectively, for the first quarter.

Martin Mucci, President and Chief Executive Officer, commented, “We had a solid start to the fiscal year as we experienced good progress across our major business lines. Our human resource (“HR”) outsourcing services, time and attendance solutions, and retirement services performed well. In addition, demand for our professional employer organization (“PEO”) business continues to grow.

We are committed to offering advanced solutions to help our clients thrive and meet their evolving business needs. During the quarter, we provided a set of enhancements to our solutions that will streamline payroll processes and support business owners and HR professionals as they work to optimize operations, comply with regulations, and drive productivity.”

Mucci added, “We are excited to be introducing several new solutions at the 2019 HR Technology Conference & Exposition[®], which is currently taking place in Las Vegas. This includes wearable technology for tracking time worked, pay-on-demand, the next generation of the Paychex Flex[®] intelligence engine, and an API integration network. Our investments in technology focus on meeting the evolving needs of our clients and their employees by providing a more flexible, personalized work experience.”

Management Solutions revenue was \$724.5 million for the first quarter, a 5% increase compared to the same period last year. The increase was primarily driven by increases in our client bases across many of our services and growth in revenue per client, which improved as a result of price increases, net of discounts. Retirement services revenue also benefited from an increase in asset fee revenue earned on the asset value of participants’ funds.

PEO and Insurance Services revenue was \$247.0 million for the first quarter, an increase of 56% compared to the same period last year. In addition to the acquisition of Oasis, this increase was driven by growth in clients and client worksite employees across our existing PEO business. Insurance Services revenue was moderated by softness in the workers’ compensation market as state insurance fund rates declined. This was partially offset by an increase in the number of health and benefit clients and applicants.

Interest on funds held for clients increased 20% to \$20.5 million for the first quarter, compared to the same period last year. The increase resulted primarily from higher average interest rates earned. Funds held for clients average investment balances increased 1% for the first quarter compared to the same period last year, as the impact of wage inflation and increases within our client base were offset by changes in client base mix and timing of collections and remittances.

Average investment balances and interest rates are summarized below:

\$ in millions	For the three months ended		Change
	August 31,		
	2019	2018	
Average investment balances:			
Funds held for clients	\$ 3,744.6	\$ 3,694.7	1%
Corporate cash equivalents and investments	\$ 862.0	\$ 884.3	(3)%
Average interest rates earned (exclusive of net realized gains/(losses)):			
Funds held for clients	2.1 %	1.9 %	
Corporate cash equivalents and investments	1.8 %	1.4 %	
Total net realized gains	\$ 0.9	\$ 0.1	

Total expenses increased 18% to \$642.9 million for the first quarter compared to the same period last year. Increases in compensation-related costs, PEO direct insurance costs, and amortization of intangible assets contributed to total expense growth for the first quarter, primarily driven by the acquisition of Oasis.

Operating income increased 9% to \$349.1 million for the first quarter compared to the same period last year. Operating margin was 35.2% for the first quarter, compared to 37.1% for the same period last year. Operating margin for the first quarter was primarily impacted by the continued growth of our PEO business, including the acquisition of Oasis, and by increased investments in technology and certain business initiatives. EBITDA⁽¹⁾ increased 13% to \$403.0 million for the first quarter and EBITDA margin⁽¹⁾ was 41% for the first quarter, consistent with the same period last year.

⁽¹⁾ EBITDA and EBITDA margin are not U.S. GAAP measures.

Other expense, net for the first quarter of \$4.8 million includes interest expense of \$8.3 million related to our long-term borrowings.

Our effective income tax rate was 23.3% for the first quarter compared to 24.5% for the same period last year. The effective income tax rate in the prior year included discrete tax expense related to the revaluation of deferred tax balances for legislative updates. The effective income tax rates in both periods were impacted by the recognition of net discrete tax benefits related to employee stock-based compensation payments.

Financial Position and Liquidity

Our financial position as of August 31, 2019 remained strong with cash, restricted cash, and total corporate investments of \$695.3 million. Total short-term and long-term borrowings, net of debt issuance costs were \$853.0 million as of August 31, 2019. Our positive cash flows have historically allowed us to support our business and to pay substantial dividends (targeting approximately 80% of net income) to our stockholders. We anticipate that cash, restricted cash, and total corporate investments as of August 31, 2019, along with projected operating cash flows and available short-term financing, will support our normal business operations, capital purchases, share repurchases and dividend payments for the foreseeable future.

Cash flows from operations were \$294.8 million for the first quarter, an increase of 8% from the same period last year. The increase in our operating cash flows was primarily the result of higher net income and non-cash adjustments, offset by fluctuations in operating assets and liabilities. The increase in non-cash adjustments was primarily due to higher amortization expense related to intangible assets acquired through the acquisition of Oasis. The fluctuations in our operating assets and liabilities were primarily due to the timing of collections and related tax payments for our PEO business.

During the first quarter, we repurchased 2.0 million shares of our common stock for a total of \$171.9 million. In the respective prior year period, we repurchased 0.5 million shares for a total of \$32.8 million.

Non-GAAP Financial Measures

\$ in millions	For the three months ended		Change
	August 31,		
	2019	2018 ⁽¹⁾	
Net income	\$ 264.2	\$ 243.6	8 %
Non-GAAP adjustments:			
Excess tax benefit related to employee stock-based compensation payments ⁽²⁾	(6.6)	(3.3)	
Revaluation of net deferred tax liabilities ⁽³⁾	—	1.7	
Total non-GAAP adjustments	(6.6)	(1.6)	
Adjusted net income	\$ 257.6	\$ 242.0	6 %
Diluted earnings per share	\$ 0.73	\$ 0.67	9 %
Non-GAAP adjustments:			
Excess tax benefit related to employee stock-based compensation payments ⁽²⁾	(0.02)	(0.01)	
Revaluation of net deferred tax liabilities ⁽³⁾	—	—	
Total non-GAAP adjustments	(0.02)	—	
Adjusted diluted earnings per share	\$ 0.71	\$ 0.67	6 %
Net income	\$ 264.2	\$ 243.6	8 %
Non-GAAP adjustments:			
Interest expense/(income), net	5.8	(2.3)	
Income taxes	80.1	79.0	
Depreciation and amortization expense	52.9	35.9	
Total non-GAAP adjustments	138.8	112.6	
Earnings before interest, taxes, depreciation and amortization	\$ 403.0	\$ 356.2	13 %

(1) The calculation of the impact of non-GAAP adjustments on diluted earnings per share is performed on each line independently. The table may not add down by +/- \$0.01 due to rounding.

(2) Net tax windfall benefits related to employee stock-based compensation payments recognized in income taxes. This item is subject to volatility and will vary based on employee decisions on exercising employee stock options and fluctuations in our stock price, neither of which is within the control of management.

(3) One-time tax charge that was recognized during the three months ended August 31, 2018 as a result of updated guidance on Internal Revenue Code Section 162(m). This event is not expected to recur.

In addition to reporting net income and diluted earnings per share, which are U.S. GAAP measures, we present adjusted net income, adjusted diluted earnings per share, and EBITDA, which are non-GAAP measures. We believe adjusted net income, adjusted diluted earnings per share, and EBITDA are appropriate additional measures, as they are indicators of our core business operations performance period over period. Adjusted net income, adjusted diluted earnings per share, and EBITDA are not calculated through the application of U.S. GAAP and are not required forms of disclosure by the Securities and Exchange Commission ("SEC"). As such, they should not be considered as a substitute for the U.S. GAAP measures of net income and diluted earnings per share, and therefore should not be used in isolation, but in conjunction with the U.S. GAAP measures. The use of any non-GAAP measure may produce results that vary from the U.S. GAAP measure and may not be comparable to a similarly defined non-GAAP measure used by other companies.

Outlook

Our outlook for the fiscal year ending May 31, 2020 (“fiscal 2020”), is based upon current market expectations and economic conditions continuing with no significant changes. We have updated our guidance as a result of current business trends. Our updated guidance is as follows:

- Management Solutions revenue is anticipated to grow approximately 5%;
- PEO and Insurance Services revenue is anticipated to grow approximately 30%;
- Other expense, net is anticipated to be in the range of \$18 million to \$20 million;
- Net income and diluted earnings per share are both expected to grow approximately 9%; and
- Adjusted net income⁽¹⁾ and adjusted diluted earnings per share⁽¹⁾ are both expected to increase approximately 9%.

Other aspects of our guidance for fiscal 2020 remain unchanged from what we provided previously.

⁽¹⁾ Adjusted net income and adjusted diluted earnings per share are non-GAAP measures. Please refer to the “Non-GAAP Financial Measures” section on page 4 of this press release for a discussion of these non-GAAP measures.

Quarterly Report on Form 10-Q

We anticipate filing our Quarterly Report on Form 10-Q (“Form 10-Q”) for the first quarter within the next few days, and it will be available at our [Investor Relations Page](#). This press release should be read in conjunction with the Form 10-Q and the related Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in that Form 10-Q.

Conference Call

Interested parties may access the webcast of our Earnings Release Conference Call, scheduled for October 2, 2019 at 9:30 a.m. Eastern Time, at our [Investor Relations Page](#). The webcast will be archived for approximately one month. Our news releases, current financial information, SEC filings, and investor presentations are also accessible at our [Investor Relations Page](#).

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About Paychex

Paychex, Inc. (Nasdaq:PAYX) is a leading provider of integrated human capital management solutions for human resources, payroll, benefits, and insurance services. By combining its innovative software-as-a-service technology and mobility platform with dedicated, personal service, Paychex empowers small- and medium-sized business owners to focus on the growth and management of their business. Backed by more than 45 years of industry expertise, Paychex serves approximately 670,000 payroll clients as of May 31, 2019 across more than 100 locations in the U.S. and Europe, and pays one out of every 12 American private sector employees. Learn more about Paychex by visiting paychex.com and stay connected on [Twitter](#) and [LinkedIn](#).

Cautionary Note Regarding Forward-Looking Statements Pursuant to the U.S. Private Securities Litigation Reform Act of 1995

Certain written and oral statements made by us may constitute “forward-looking statements” within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by such words and phrases as “we expect,” “expected to,” “estimates,” “estimated,” “overview,” “current outlook,” “guidance,” “we look forward to,” “would equate to,” “projects,” “projections,” “projected,” “projected to be,” “anticipates,” “anticipated,” “we believe,” “believes,” “could be,” “targeting,” and other similar words or phrases. Examples of forward-looking statements include, among others, statements we make regarding operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to our outlook, revenue growth, earnings, earnings-per-share growth, or similar projections.

Forward-looking statements are neither historical facts nor assurances of future performance. Instead, they are based only on our current beliefs, expectations, and assumptions regarding the future of our business, future plans and strategies, projections, anticipated events and trends, the economy, and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks, and changes in circumstances that are difficult to predict, many of which are outside our control. Our actual results and financial conditions may differ materially from those indicated in the forward-looking statements. Therefore, you should not place undue reliance upon any of these forward-looking statements. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, among others, the following:

- changes in governmental regulations and policies;
- our ability to comply with U.S. and foreign laws and regulations;
- our ability to keep pace with changes in technology and to provide timely enhancements to our products and services;
- our compliance with data privacy laws and regulations;
- the possibility of cyberattacks, security vulnerabilities and Internet disruptions, including breaches of data security and privacy leaks, data loss and business interruptions;
- the possibility of failure of our operating facilities, computer systems, or communication systems during a catastrophic event;
- the failure of third-party service providers to perform their functions;
- the possibility that we may be subject to additional risks related to our co-employment relationship with our PEO;
- changes in health insurance and workers’ compensation insurance rates and underlying claim trends;
- our clients’ failure to reimburse us for payments made by us on their behalf;
- the effect of changes in government regulations mandating the amount of tax withheld or the timing of remittances;
- volatility in the political and economic environment;

- risks related to acquisitions and the integration of the businesses we acquire, including integrating Oasis' business with ours;
- our failure to comply with covenants in our debt agreements;
- changes in the availability of qualified people, including management, technical, compliance and sales personnel;
- our failure to protect our intellectual property rights;
- the possible effects of negative publicity on our reputation and the value of our brand; and
- potential outcomes related to pending or future litigation matters.

Any of these factors, as well as such other factors as discussed in our SEC filings, could cause our actual results to differ materially from our anticipated results. The information provided in this document is based upon the facts and circumstances known as of the date of this press release, and any forward-looking statement made by us in this document speaks only as of the date on which it is made. Except as required by law, we undertake no obligation to update these forward-looking statements after the date of issuance of this press release to reflect events or circumstances after such date, or to reflect the occurrence of unanticipated events.

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(In millions, except per share amounts)

	For the three months ended		Change
	August 31,		
	2019	2018	
Revenue:			
Management Solutions	\$ 724.5	\$ 687.7	5%
PEO and Insurance Services	247.0	158.0	56%
Total service revenue	971.5	845.7	15%
Interest on funds held for clients ⁽¹⁾	20.5	17.1	20%
Total revenue	992.0	862.8	15%
Expenses:			
Operating expenses	325.4	265.5	23%
Selling, general and administrative expenses	317.5	277.0	15%
Total expenses	642.9	542.5	18%
Operating income	349.1	320.3	9%
Other (expense)/income, net ⁽¹⁾	(4.8)	2.3	n/m
Income before income taxes	344.3	322.6	7%
Income taxes	80.1	79.0	1%
Net income	\$ 264.2	\$ 243.6	8%
Basic earnings per share	\$ 0.74	\$ 0.68	9%
Diluted earnings per share	\$ 0.73	\$ 0.67	9%
Weighted-average common shares outstanding	358.6	359.1	
Weighted-average common shares outstanding, assuming dilution	361.5	361.5	

⁽¹⁾ Further information on interest on funds held for clients and other (expense)/income, net, and the short- and long-term effects of changing interest rates can be found in our filings with the SEC, including our Quarterly Reports on Form 10-Q and our Annual Report on Form 10-K, as applicable, under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" and subheadings "Results of Operations" and "Market Risk Factors." These filings are accessible at www.paychex.com.

n/m – not meaningful

PAYCHEX, INC.
CONSOLIDATED BALANCE SHEETS (Unaudited)
(In millions, except per share amounts)

	August 31, 2019	May 31, 2019
ASSETS		
Cash and cash equivalents	\$ 586.4	\$ 673.6
Restricted cash	55.8	50.6
Corporate investments	40.9	39.0
Interest receivable	27.1	27.4
Accounts receivable, net of allowance for doubtful accounts	425.1	420.5
PEO unbilled receivables, net of advance collections	409.2	406.3
Prepaid income taxes	—	22.6
Prepaid expenses and other current assets	242.3	233.9
Current assets before funds held for clients	1,786.8	1,873.9
Funds held for clients	3,769.1	3,803.8
Total current assets	5,555.9	5,677.7
Long-term restricted cash	1.9	6.5
Long-term corporate investments	10.3	10.2
Property and equipment, net of accumulated depreciation	403.4	408.7
Operating lease right-of-use assets, net of accumulated amortization	112.8	—
Intangible assets, net of accumulated amortization	379.5	399.1
Goodwill	1,783.1	1,782.6
Long-term deferred costs	362.7	366.3
Other long-term assets	28.6	24.9
Total assets	\$ 8,638.2	\$ 8,676.0
LIABILITIES		
Accounts payable	\$ 61.7	\$ 75.9
Accrued corporate compensation and related items	84.5	146.4
Accrued worksite employee compensation and related items	544.1	578.6
Accrued income taxes	49.0	—
Short-term borrowings	56.5	—
Deferred revenue	41.3	40.3
Other current liabilities	270.5	219.5
Current liabilities before client fund obligations	1,107.6	1,060.7
Client fund obligations	3,715.9	3,784.3
Total current liabilities	4,823.5	4,845.0
Accrued income taxes	29.7	27.3
Deferred income taxes	227.6	223.1
Long-term borrowings, net of debt issuance costs	796.5	796.4
Operating lease liabilities	93.8	—
Other long-term liabilities	147.8	164.7
Total liabilities	6,118.9	6,056.5
STOCKHOLDERS' EQUITY		
Common stock, \$0.01 par value; Authorized: 600.0 shares; Issued and outstanding: 357.9 shares as of August 31, 2019 and 359.3 shares as of May 31, 2019	3.6	3.6
Additional paid-in capital	1,224.0	1,206.3
Retained earnings	1,265.2	1,409.5
Accumulated other comprehensive income	26.5	0.1
Total stockholders' equity	2,519.3	2,619.5
Total liabilities and stockholders' equity	\$ 8,638.2	\$ 8,676.0

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In millions)

	For the three months ended	
	August 31,	
	2019	2018 ⁽¹⁾
OPERATING ACTIVITIES		
Net income	\$ 264.2	\$ 243.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization on property and equipment and intangible assets	52.9	35.9
Amortization of premiums and discounts on available-for-sale securities, net	10.0	14.4
Amortization of deferred contract costs	46.0	44.6
Stock-based compensation costs	10.5	10.9
(Benefit)/provision for deferred income taxes	(3.7)	2.6
Provision for allowance for doubtful accounts	2.3	0.3
Net realized (gains)/losses on sales of available-for-sale securities	(0.9)	0.1
Changes in operating assets and liabilities:		
Interest receivable	0.3	3.1
Accounts receivable and PEO unbilled receivables, net	(9.8)	(43.0)
Prepaid expenses and other current assets	13.8	15.2
Accounts payable and other current liabilities	(39.6)	(15.2)
Deferred costs	(41.9)	(38.4)
Net change in other long-term assets and liabilities	(8.4)	(0.4)
Net change in operating lease right-of-use assets and liabilities	(0.9)	—
Net cash provided by operating activities	294.8	273.7
INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(8,289.3)	(11,115.8)
Proceeds from sales and maturities of available-for-sale securities	8,862.1	11,297.0
Purchases of property and equipment	(26.4)	(24.4)
Purchases of other assets	(1.7)	(0.8)
Net cash provided by investing activities	544.7	156.0
FINANCING ACTIVITIES		
Net change in client fund obligations	(68.4)	(942.5)
Net proceeds from short-term borrowings	56.5	56.7
Dividends paid	(222.0)	(201.4)
Repurchases of common shares	(171.9)	(32.8)
Activity related to equity-based plans	(7.4)	9.7
Net cash used in financing activities	(413.2)	(1,110.3)
Net change in cash, cash equivalents, restricted cash and restricted cash equivalents	426.3	(680.6)
Cash, cash equivalents, restricted cash and restricted cash equivalents, beginning of period	935.2	2,300.5
Cash, cash equivalents, restricted cash and restricted cash equivalents, end of period	\$ 1,361.5	\$ 1,619.9
Reconciliation of cash, cash equivalents, restricted cash and restricted cash equivalents to the Consolidated Balance Sheets:		
Cash and cash equivalents	\$ 586.4	\$ 440.1
Restricted cash	57.7	—
Restricted cash and restricted cash equivalents included in funds held for clients	717.4	1,179.8
Total cash, cash equivalents, restricted cash and restricted cash equivalents	\$ 1,361.5	\$ 1,619.9

(1) Amounts have been adjusted to reflect adoption of Accounting Standards Update No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)."

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