

Ticker: **PAYX**

Major Stock Index: **S&P 500**

Stock Picking Philosophy

With its cost- and tax-efficient investment approach Herges Capital invests in individual stocks from the U.S. and abroad. Subsequently avoiding fee-intensive mutual funds and even low-cost Exchange Traded Funds (ETFs). Unlike with funds dividends are received immediately and continuously. Also ethical investment considerations can be expressed and realized.

The quantitative stock selection process aims for firms whose earnings are less likely to surprise negatively. The expectation being that over the long term a diversified portfolio of those carefully-selected picks yields a higher return than the general stock market.

Paychex (ticker **PAYX**) is such top candidate in Herges Capital's selection process.

THIS IS NOT A STOCK PURCHASE OR SELL RECOMMENDATION.

INSTEAD THIS PIECE EXPLAINS HERGES CAPITAL'S STOCK SELECTION PHILOSOPHY GIVEN A CONCRETE EXAMPLE. IT IS MEANT TO FURTHER FAMILIARIZE HERGES CAPITAL CLIENTS WITH THE REASONING AND FINANCIAL DATA BEHIND A POSSIBLE SINGLE STOCK INVESTMENT. HERGES CAPITAL AND ITS CLIENTS MAY OR MAY NOT HAVE A POSITION IN THIS PARTICULAR NAME AT ANY GIVEN TIME.

About Paychex

Paychex offers comprehensive Human Resources (HR) solutions, including payroll, timekeeping, training, compliance, hiring, tax and retirement plans. The stock is categorized in the **INFORMATION TECHNOLOGY** sector within the 'Data Processing & Outsourced Services' sub-industry. Main competitors are Automatic Data Processing (ticker **ADP**) and the still private Gusto.

Paychex serves over 650,000 payroll clients mainly in the U.S. and Germany. The firm has about 14,500 employees.

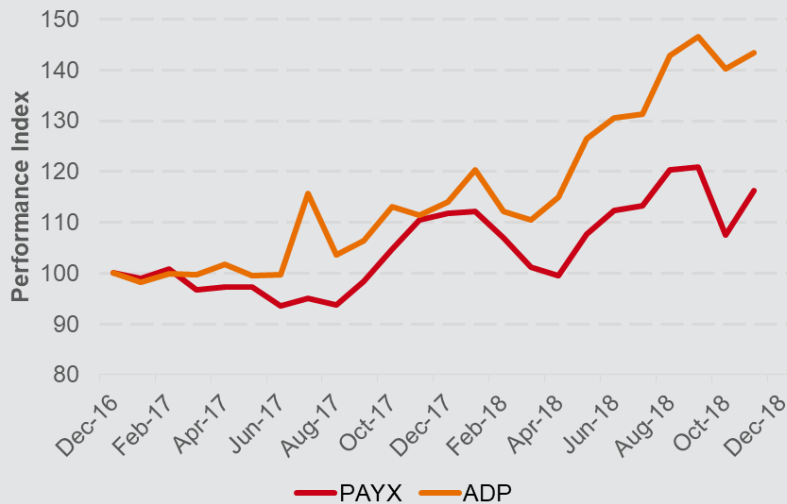


Chart 1: Paychex recently under-performed its direct competitor ADP. Monthly data since Dec 2016. Source: investing.com

Paychex is pursuing expansion in the U.S. but especially in Europe. In March 2018 the Danish Lessor Group with its Scandinavian clients was acquired. In November 2018 the Florida-based Oasis Outsourcing was bought for \$1.2bn cash adding another 8,400 clients to the U.S.

Stable Earnings

One of the most influential factors in Herges Capital’s stock selection process is past earnings per share. Stable historical earnings reduce the risk of negative surprises in the future.

Paychex’s historical earnings are constantly upward sloping. While earnings per share cannot be compared directly between stocks of different prices, it is evident in chart 2 that Paychex’s figures have been more reliable than ADP’s. Don’t be confused by the higher absolute EPS number.

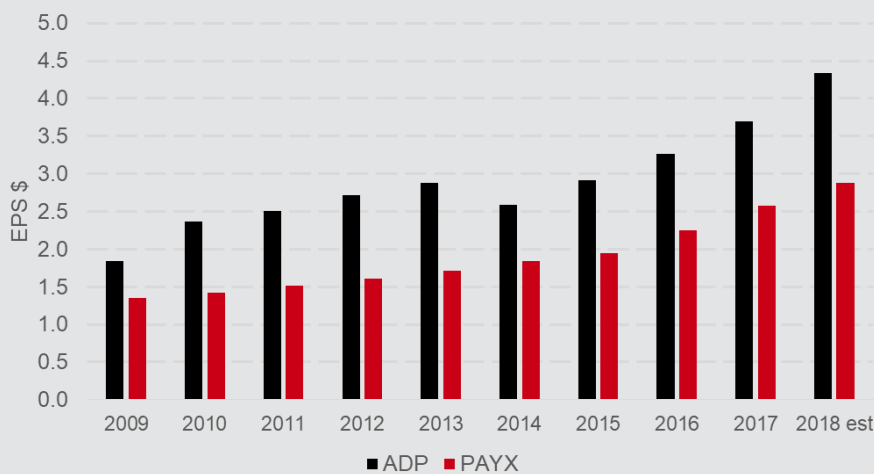


Chart 2: Historical Earnings per Share (EPS). Source: fidelity.com

Dividends

Paychex has a high payout ratio of 75%-80%. Meaning a dominant portion of income is typically distributed directly to investors through ordinary dividends.

Paychex currently offers a 3.1% dividend yield, higher than ADP's 2.1%. Matching Paychex's positive earnings development, dividends increased between 7%-14% during the past years (see chart 3).

Dividend paying abilities plays no role in Herges Capital's stock selection process. Dividends are only as safe as consistent earnings back them. So the primary selection criterion is earnings and not the derivative dividends.

Investors in need of cash distributions can always partially sell existing positions. The advantage being that they are able to do so at their own frequency and amount. In addition, investors holding multiple positions could choose sell candidates in a tax-efficient way. In contrast, dividend payouts typically necessitate the need to re-invest in order to reduce the cash drag.

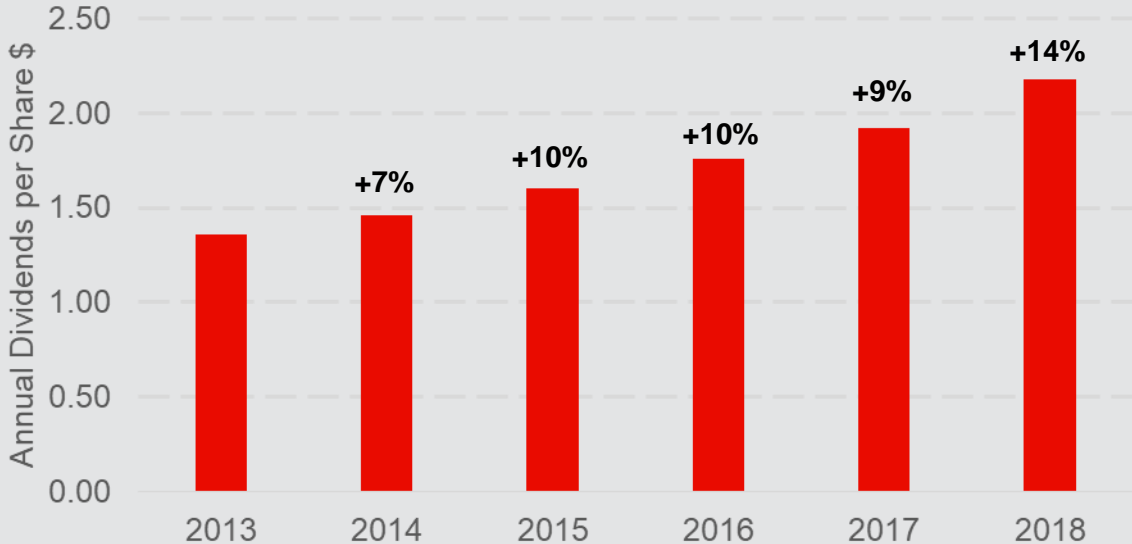


Chart 3: Paychex' annual regular dividend growth.
Source: fidelity.com

Size, Index Membership and Ownership

Paychex is still number two in its field behind its main competitor ADP. The \$24.9bn market cap is less than half of ADP's \$63bn.

Both firms are members of the prestigious S&P 500 stock index as well as the NASDAQ 100.

As it is typical for larger cap stocks, Blackrock and the Vanguard Group are main shareholders owning more than 14% of Paychex' outstanding shares. That is similar to ADP.

History

Aiming predominantly for small businesses, 29-years old B. Thomas Golisano founded PayMaster in Rochester, NY in 1971. The firm incorporated as Paychex in 1979. Its Initial Public Offering (IPO) was in 1983 and 15 years later the stock joined the S&P 500 stock index.

December 2018

Dr. Udo Herges
CEO



HERGES
CAPITAL MANAGEMENT

Herges Capital Management LLC is a State of California registered Investment Advisor (IA). Firm CRD #288600.