PAYCHEX INC
Form 10-Q
October 05, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended August 31, 2018

Commission file number 0-11330

PAYCHEX, INC.

911 Panorama Trail South

Rochester, New York 14625-2396

(585) 385-6666

A Delaware Corporation

IRS Employer Identification Number: 16-1124166

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company |
| | | | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date:

| | | |
|---|---|---|
| Common Stock, $0.01 Par Value | 359,081,940 | Shares |
| CLASS | OUTSTANDING AS OF | September 30, 2018 |

PAYCHEX, INC.

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PAYCHEX, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

In millions, except per share amounts

| | For the three months ended August 31, | |
|---|---|---|
| | 2018 | 2017 As Adjusted(1) |
| Revenue: | | |
| Management Solutions | $ 687.7 | $ 665.9 |
| PEO and Insurance Services | 158.0 | 113.3 |
| Total service revenue | 845.7 | 779.2 |
| Interest on funds held for clients | 17.1 | 13.7 |
| Total revenue | 862.8 | 792.9 |
| Expenses: | | |
| Operating expenses | 265.5 | 232.0 |
| Selling, general and administrative expenses | 277.0 | 243.6 |
| Total expenses | 542.5 | 475.6 |
| Operating income | 320.3 | 317.3 |
| Investment income, net | 2.3 | 2.1 |
| Income before income taxes | 322.6 | 319.4 |
| Income taxes | 79.0 | 109.0 |
| Net income | $ 243.6 | $ 210.4 |
| | | |
| Other comprehensive income, net of tax | 0.4 | 4.4 |
| Comprehensive income | $ 244.0 | $ 214.8 |
| | | |
| Basic earnings per share | $ 0.68 | $ 0.59 |
| Diluted earnings per share | $ 0.67 | $ 0.58 |
| Weighted-average common shares outstanding | 359.1 | 358.9 |
| Weighted-average common shares outstanding, assuming dilution | 361.5 | 361.3 |
| Cash dividends per common share | $ 0.56 | $ 0.50 |

(1) Amounts have been adjusted to reflect the adoption of Accounting Standards Codification (“ASC”) Topic 606, “Revenue from Contracts with Customers” (“ASC Topic 606”).

See Notes to Consolidated Financial Statements.

Table of Contents

PAYCHEX, INC.

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

In millions, except per share amount

| | August 31, 2018 | May 31, 2018 As Adjusted(1) |
|---|---|---|
| Assets | | |
| Cash and cash equivalents | $ 440.1 | $ 358.2 |
| Corporate investments | 82.9 | 66.0 |
| Interest receivable | 29.1 | 32.2 |
| Accounts receivable, net of allowance for doubtful accounts | 535.2 | 492.4 |
| Prepaid income taxes | — | 17.0 |
| Prepaid expenses and other current assets | 225.1 | 224.0 |
| Current assets before funds held for clients | 1,312.4 | 1,189.8 |
| Funds held for clients | 3,763.8 | 4,703.8 |
| Total current assets | 5,076.2 | 5,893.6 |
| Long-term corporate investments | 264.6 | 295.5 |
| Property and equipment, net of accumulated depreciation | 389.1 | 393.5 |
| Intangible assets, net of accumulated amortization | 135.5 | 141.4 |
| Goodwill | 813.3 | 814.0 |
| Long-term deferred costs | 355.6 | 361.0 |
| Other long-term assets | 15.7 | 16.4 |
| Total assets | $ 7,050.0 | $ 7,915.4 |
| Liabilities | | |
| Accounts payable | $ 62.6 | $ 73.7 |
| Accrued compensation and related items | 283.2 | 320.6 |
| Accrued income taxes | 51.6 | — |
| Short-term borrowings | 56.7 | — |
| Deferred revenue | 36.6 | 34.6 |
| Other current liabilities | 114.2 | 132.9 |
| Current liabilities before client fund obligations | 604.9 | 561.8 |
| Client fund obligations | 3,792.5 | 4,734.9 |
| Total current liabilities | 4,397.4 | 5,296.7 |
| Accrued income taxes | 19.1 | 18.4 |
| Deferred income taxes | 155.5 | 154.4 |
| Other long-term liabilities | 91.0 | 89.1 |
| Total liabilities | 4,663.0 | 5,558.6 |

| | | |
|---|---|---|
| Commitments and contingencies — Note M | | |
| Stockholders’ equity | | |
| Common stock, $0.01 par value; Authorized: 600.0 shares; Issued and outstanding: 359.0 shares as of August 31, 2018 and May 31, 2018 | 3.6 | 3.6 |
| Additional paid-in capital | 1,151.1 | 1,126.8 |
| Retained earnings | 1,268.1 | 1,262.6 |
| Accumulated other comprehensive loss | (35.8) | (36.2) |
| Total stockholders’ equity | 2,387.0 | 2,356.8 |
| Total liabilities and stockholders’ equity | $ 7,050.0 | $ 7,915.4 |

(1) Amounts have been adjusted to reflect the adoption of ASC Topic 606.

See Notes to Consolidated Financial Statements.

2

Table of Contents

PAYCHEX, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

In millions

| | For the three months ended August 31, | |
|---|---|---|
| | 2018 | 2017 As Adjusted(1) |
| Operating activities | | |
| Net income | $ 243.6 | $ 210.4 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization on property and equipment and intangible assets | 35.9 | 32.0 |
| Amortization of premiums and discounts on available-for-sale securities, net | 14.4 | 17.1 |
| Stock-based compensation costs | 10.9 | 8.7 |
| Provision for deferred income taxes | 2.6 | 48.9 |
| Provision for allowance for doubtful accounts | 0.3 | 0.7 |
| Net realized gains on sales of available-for-sale securities | 0.1 | — |
| Changes in operating assets and liabilities: | | |
| Interest receivable | 3.1 | 3.9 |
| Accounts receivable | (43.0) | 8.8 |
| Prepaid expenses and other current assets | 15.2 | 28.2 |
| Accounts payable and other current liabilities | (15.2) | (19.8) |
| Deferred costs | 6.2 | 4.2 |
| Net change in other long-term assets and liabilities | (0.4) | 0.5 |
| Net cash provided by operating activities | 273.7 | 343.6 |
| Investing activities | | |
| Purchases of available-for-sale securities | (11,115.8) | (8,646.7) |
| Proceeds from sales and maturities of available-for-sale securities | 11,297.0 | 8,892.0 |
| Net change in funds held for clients' money market securities and other cash equivalents | 762.5 | (929.7) |
| Purchases of property and equipment | (24.4) | (18.0) |
| Acquisition of businesses, net of cash acquired | — | (8.2) |
| Purchases of other assets | (0.8) | (0.4) |
| Net cash provided by/(used in) investing activities | 918.5 | (711.0) |
| Financing activities | | |
| Net change in client fund obligations | (942.5) | 645.5 |

| | | |
|---|---|---|
| Net proceeds from short-term borrowings | 56.7 | 57.2 |
| Dividends paid | (201.4) | (179.1) |
| Repurchases of common shares | (32.8) | (94.1) |
| Activity related to equity-based plans | 9.7 | (12.3) |
| Net cash (used in)/provided by financing activities | (1,110.3) | 417.2 |
| Increase in cash and cash equivalents | 81.9 | 49.8 |
| Cash and cash equivalents, beginning of fiscal year | 358.2 | 184.6 |
| Cash and cash equivalents, end of period | $ 440.1 | $ 234.4 |

(1) Amounts have been adjusted to reflect the adoption of ASC Topic 606.

See Notes to Consolidated Financial Statements.

Table of Contents

PAYCHEX, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

August 31, 2018

Note A: Description of Business, Basis of Presentation, and Significant Accounting Policies

Description of business: Paychex, Inc. and its wholly owned subsidiaries (collectively, the "Company" or "Paychex") is a leading provider of integrated human capital management ("HCM") solutions for payroll, benefits, human resource ("HR"), and insurance services for small- to medium-sized businesses in the United States ("U.S."). The Company also has operations in Europe.

Paychex, a Delaware corporation formed in 1979, reports as one segment. Substantially all of the Company's revenue is generated within the U.S. The Company also generates revenue within Europe, which represented approximately one percent of the Company's total revenue for the three months ended August 31, 2018 and was less than one percent of the Company's total revenue for the three months ended August 31, 2017. Long-lived assets in Europe were approximately 10% of total long-lived assets of the Company as of August 31, 2018 and May 31, 2018.

Basis of presentation: The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to the Quarterly Report on Form 10-Q ("Form 10-Q") and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statement presentation. The consolidated financial statements include the consolidated accounts of the Company with all intercompany transactions eliminated. In the opinion of management, the information furnished herein reflects all adjustments (consisting of items of a normal recurring nature), which are necessary for a fair statement of the results for the interim period. These consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and related Notes to Consolidated Financial Statements presented in the Company's Annual Report on Form 10-K ("Form 10-K") for the fiscal year ended May 31, 2018 ("fiscal 2018"). Operating results and cash flows for the three months ended August 31, 2018 are not necessarily indicative of the results that may be expected for other interim periods or for the fiscal year ending May 31, 2019 ("fiscal 2019").

Effective June 1, 2018, the Company adopted the requirements of Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," as discussed in "Recently adopted accounting pronouncements." All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standard, as indicated by the "As Adjusted" footnote.

Reclassifications:  Certain prior period amounts have been reclassified to conform to the current period presentation in connection with the adoption of ASU No. 2014-09 and had no effect on reported consolidated earnings.

PEO insurance reserves: As part of the professional employer organization (“PEO”) service, the Company offers workers' compensation insurance and health insurance to client companies for the benefit of client employees. For workers' compensation insurance, reserves are established to provide for the estimated costs of paying claims up to per occurrence liability limits. The Company’s maximum individual claims liability, excluding HR Outsourcing Holdings, Inc. (“HROI”), was $1.0 million and $1.3 million under its fiscal 2019 and fiscal 2018 workers' compensation insurance policies, respectively. HROI’s maximum individual claims liability was $0.5 million under its workers’ compensation insurance policies for the years ending September 30, 2018 and September 30, 2017.

Under the minimum premium insurance plan offering within the PEO, the Company's health benefits insurance reserves are established to provide for the payment of claims liability charges in accordance with its service contract with the insurance carrier. The Company's maximum individual claims liability, excluding HROI, was $0.3 million under both its calendar 2018 and 2017 minimum premium insurance plan policies. HROI’s maximum individual claims liability was $0.3 million under its minimum premium insurance plan policies for the years ending June 30, 2019 and June 30, 2018.  In addition, the Company also provides self-insured dental and vision plans.

Estimating the ultimate cost of future claims is an uncertain and complex process based upon historical loss experience and actuarial loss projections, and is subject to change due to multiple factors, including economic trends, changes in legal liability law, and damage awards, all of which could materially impact the reserves as reported in the consolidated financial statements. Accordingly, final claim settlements may vary from the present estimates, particularly with workers' compensation insurance where those payments may not occur until well into the future. The Company regularly reviews the adequacy of its estimated insurance reserves. Adjustments to previously established insurance reserves are reflected in the results of operations for the period in which such adjustments are identified. Such adjustments could be significant, reflecting any combination of new and adverse or favorable trends.

Table of Contents

Stock-based compensation costs: The Company has issued stock-based awards to employees and directors consisting of stock options, restricted stock awards, restricted stock units, performance shares, performance-based restricted stock, and performance-based stock options. The Company accounts for all stock-based awards to employees and directors as compensation costs in the consolidated financial statements based on their fair values measured as of the date of grant. These costs are recognized over the requisite service period. Stock-based compensation costs recognized were $10.9 million for the three months ended August 31, 2018, as compared with $8.7 million for the three months ended August 31, 2017. The methods and assumptions used in the determination of the fair value of stock-based awards are consistent with those described in the Company's fiscal 2018 Form 10-K.

Recently adopted accounting pronouncements: In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." This guidance, as amended by subsequent ASUs on the topic, outlines a single comprehensive model for determining revenue recognition for contracts with customers, and supersedes guidance on revenue recognition in ASC Topic 605, "Revenue Recognition." The Company adopted the new standard on June 1, 2018, utilizing the full retrospective method, which required the Company to recast each prior reporting period presented and included a cumulative adjustment to increase stockholder's equity by $262.9 million as of June 1, 2016. We have updated our control framework for new internal controls and made changes to existing controls related to the new standard.

Impact on Previously Reported Results

The provisions of ASU No. 2014-09 do not materially impact the timing or the amount of revenue the Company recognizes on an annual basis in its Consolidated Statements of Income and Comprehensive Income. However, it does have an impact on the timing and amount of revenue the Company recognizes on a quarterly basis due to changes in the way it accounts for certain revenues where performance obligations are satisfied at a point in time. The provisions of the new standard have a material impact on the Company's Consolidated Balance Sheets. The primary impact of adopting the new standard is on the Company's treatment of certain costs to obtain and fulfill contracts. In relation to those items, the new standard resulted in the Company deferring additional costs on its Consolidated Balance Sheets and amortizing them to the Consolidated Statements of Income and Comprehensive Income over the estimated average life of the client. Refer to Note B for further details.

The following table presents a recast of selected unaudited consolidated statements of income and comprehensive income line items after giving effect to the adoption of ASU No. 2014-09:

| | For the three months ended August 31, 2017 |
|---|---|
| | As Previously |

| In millions, except per share amounts | Reported | Adjustments | As Adjusted |
|---|---|---|---|
| Service revenue | $ 803.1 | $ (23.9) | $ 779.2 |
| Operating expenses | 232.1 | (0.1) | 232.0 |
| Selling, general and administrative expenses | 239.7 | 3.9 | 243.6 |
| Total expenses | 471.8 | 3.8 | 475.6 |
| Operating income | 345.0 | (27.7) | 317.3 |
| Income taxes | 119.3 | (10.3) | 109.0 |
| Net income | $ 227.8 | $ (17.4) | $ 210.4 |
| Basic earnings per share | $ 0.63 | $ (0.04) | $ 0.59 |
| Diluted earnings per share | $ 0.63 | $ (0.05) | $ 0.58 |

Table of Contents

The following table presents a recast of selected unaudited consolidated balance sheet line items after giving effect to the adoption of ASU No. 2014-09:

| | May 31, 2018 | | |
|---|---|---|---|
| In millions | As Previously Reported | Adjustments | As Adjusted |
| Assets | | | |
| Accounts receivable, net of allowance for doubtful accounts | $ 531.4 | $ (39.0) | $ 492.4 |
| Prepaid expenses and other current assets | $ 75.8 | $ 148.2 | $ 224.0 |
| Long-term deferred costs(1) | $ 18.5 | $ 342.5 | $ 361.0 |
| Liabilities and stockholders' equity | | | |
| Accounts payable | $ 74.5 | $ (0.8) | $ 73.7 |
| Deferred revenue | $ 24.3 | $ 10.3 | $ 34.6 |
| Deferred income taxes | $ 48.8 | $ 105.6 | $ 154.4 |
| Other long-term liabilities | $ 84.8 | $ 4.3 | $ 89.1 |
| Retained earnings | $ 930.3 | $ 332.3 | $ 1,262.6 |

(1) Amounts were previously reported as a component of other long-term assets on the Consolidated Balance Sheets included in the Company’s fiscal 2018 Form 10-K.  Long-term deferred costs are separately stated on the Consolidated Balance Sheets contained in this Form 10-Q.

The following table presents a recast of selected unaudited consolidated statement of cash flow line items after giving effect to the adoption of ASU No. 2014-09:

| | For the three months ended August 31, 2017 | | |
|---|---|---|---|
| In millions | As Previously Reported | Adjustments | As Adjusted |
| Cash flows from operating activities | | | |
| Net income | $ 227.8 | $ (17.4) | $ 210.4 |

| | | | |
|---|---|---|---|
| Provision for deferred income taxes | $ 59.2 | $ (10.3) | $ 48.9 |
| Accounts receivable | $ (15.4) | $ 24.2 | $ 8.8 |
| Deferred costs | $ — | $ 4.2 | $ 4.2 |
| Accounts payable and other current liabilities | $ (19.2) | $ (0.6) | $ (19.8) |
| Net change in other long-term assets and liabilities | $ 0.6 | $ (0.1) | $ 0.5 |

In June 2018, the Company also adopted the following ASUs, none of which had a material impact on its consolidated financial statements:

· ASU No. 2017-05, "Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets."

· ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)."

· ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory."

· ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)."

· ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities."

Table of Contents

Recently issued accounting pronouncements: In August 2018, the FASB issued ASU No. 2018-15, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (a consensus of the FASB Emerging Issues Task Force).” ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). This guidance is effective for fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years, with early adoption permitted. This guidance is applicable to the Company’s fiscal year beginning June 1, 2020. The Company is currently evaluating the potential effects of this guidance on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement.” ASU 2018-13 modified the disclosure requirements in Topic 820, “Fair Value Measurement,” based on the FASB Concepts Statement, “Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements,” including consideration of costs and benefits. This guidance is effective for fiscal years beginning after December 15, 2019, and for interim periods within those fiscal years, with early adoption permitted. This guidance is applicable to the Company’s fiscal year beginning June 1, 2020. The Company is currently evaluating the potential effects of this guidance on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” This guidance, as amended by subsequent ASUs on the topic, improves transparency and comparability among companies by recognizing lease assets and lease liabilities on the balance sheet and by disclosing key information about leasing arrangements. ASU No. 2016-02 is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2018, with early adoption permitted. This guidance is applicable to the Company's fiscal year beginning June 1, 2019. The Company is gathering data and assessing the impact of the new lease accounting standard and the Company anticipates that the adoption of the new lease accounting standard will result in additional assets and liabilities being recorded on its Consolidated Balance Sheets.

Other recent authoritative guidance issued by the FASB (including technical corrections to the ASC), the American Institute of Certified Public Accountants, and the Securities Exchange Commission (“SEC”) during the three months ended August 31, 2018 did not, or are not expected to, have a material effect on the Company’s consolidated financial statements.

Note B: Service Revenue

Service revenue is primarily attributable to fees for providing services to the Company’s clients and are recognized when control of the promised services are transferred to its clients, in an amount that reflects the consideration it expects to receive in exchange for such services. The Company’s service revenue is largely attributable to processing services where the fee is based on a fixed amount per processing period or a fixed amount per processing period plus a fee per employee or transaction processed. The Company's contracts generally have a term of 30 days as they are cancellable at any time by either party with 30-days' notice of termination. Sales and other applicable taxes are excluded from service revenue.

Based upon similar operational and economic characteristics, the Company's service revenue is disaggregated by Management Solutions and PEO and Insurance Services as reported on the Company's Consolidated Statements of Income and Comprehensive Income. The Company believes these revenue categories depict how the nature, amount, timing, and uncertainty of its revenue and cash flows are affected by economic factors.

Revenue earned from delivery service for the distribution of certain client payroll checks and reports is included in Management Solutions revenue on the Company's Consolidated Statements of Income and Comprehensive Income. Delivery service revenue is recognized at a point in time following the delivery of payroll checks, reports, quarter-end packages, and tax returns to the Company's clients.

The following table, consistent with the Consolidated Statements of Income and Comprehensive Income, disaggregates service revenue by Management Solutions and PEO and Insurance Services:

| | For the three months ended August 31, | |
|---|---|---|
| In millions | 2018 | 2017 As Adjusted |
| Management Solutions | $ 687.7 | $ 665.9 |
| PEO and Insurance Services | 158.0 | 113.3 |
| Total service revenue | $ 845.7 | $ 779.2 |

Management Solutions Revenue

Management Solutions revenue is primarily derived from the Company’s payroll processing, payroll-related ancillary services and HR outsourcing solutions. Clients can select services on an á la carte basis or as part of various product bundles. The Company’s offerings often leverage the information gathered in its base payroll processing service, allowing it to provide comprehensive outsourcing services covering the HCM spectrum. Management Solutions revenue is generally recognized over time as services are performed and the customer simultaneously receives and controls the benefits from these services.

PEO and Insurance Services Revenue

PEO services are sold through the Company’s registered and licensed subsidiaries, Paychex Business Solutions, LLC and HROI and offer businesses a combined package of services that includes payroll, employer compliance, HR and employee benefits administration, risk management outsourcing, and the on-site availability of a professionally trained HR representative, among other services. The Company serves as a co-employer of its clients’ employees, offers health insurance coverage to client employees, and assumes the risks and rewards of workers’ compensation insurance and certain health insurance benefit offerings. PEO revenue is recognized over time as the services are performed and the customer simultaneously receives and controls the benefits from these services. PEO revenue is reported net of certain direct pass-through costs billed and incurred, which include payroll wages, payroll taxes, including state unemployment insurance, and certain health insurance benefit premiums, primarily costs related to our guaranteed cost benefit plans. For guaranteed cost benefit plans where the Company does not retain risk, it is acting as the agent for revenue recognition purposes and revenues are recorded net of the premiums paid to the insurance carrier. Approximately 60% of the client worksite employees that participate in the Company’s benefit plans are enrolled in guaranteed cost benefit plans where the Company does not retain risk. For workers’ compensation and certain benefit plans where the Company retains risk, it is acting as the principal for revenue recognition purposes and revenues and costs are recorded on a gross basis. Approximately 40% of the client worksite employees that participate in the Company’s health insurance offerings are enrolled in these benefit plans.

Insurance services are sold through the Company’s licensed insurance agency, Paychex Insurance Agency, Inc., which provides insurance through a variety of carriers, while allowing companies to expand their employee benefit offerings at an affordable cost. Insurance offerings include property and casualty coverage such as workers’ compensation, business-owner policies, commercial auto, and health and benefits coverage, including health, dental, vision, and life. Insurance services revenue is recognized over time as services are performed and the customer simultaneously receives and controls the benefits from these services.

Contract Balances

The timing of revenue recognition for Management Solutions and PEO and Insurance Services is consistent with the invoicing of clients as they both occur during the respective client payroll period for which the services are provided. Therefore, the Company does not recognize a contract asset or liability resulting from the timing of revenue recognition and invoicing.

Advance payments received for certain of the Company's service offerings for set-up fees are considered a material right. Therefore, the Company defers revenue associated with these performance obligations, which exceed one year, and subsequently recognizes these as future services are provided, over approximately three to four years.

Changes in deferred revenue related to material right performance obligations were as follows:

| In millions | For the three months ended August 31, 2018 |
|---|---|
| Balance, beginning of period | $ 46.4 |
| Deferral of revenue | 6.1 |
| Recognition of unearned revenue | (6.8) |
| Balance, end of period | $ 45.7 |

Deferred revenue related to material right performance obligations is reported in the deferred revenue and other long-term liabilities line items on the Company's Consolidated Balance Sheets contained in this Form 10-Q.

Table of Contents

Assets Recognized from the Costs to Obtain and Fulfill Contracts

The Company recognizes an asset for the incremental costs of obtaining a contract with a client if it is expected that the amortization period will be longer than one year. The Company determined that certain selling and commission costs meet the capitalization criteria under ASC Subtopic 340-40, “Other Assets and Deferred Costs: Contracts with Customers” (“ASC 340-40”). Prior to the adoption of ASU No. 2014-09 these costs were deferred up to an amount equal to the revenue deferred and any costs in excess of that amount were recognized as expense when incurred. The Company also recognizes an asset for the costs to fulfill a contract with a client if the costs are specifically identifiable, generate or enhance resources used to satisfy future performance obligations, and are expected to be recovered. The Company has determined that substantially all costs related to implementation activities are administrative in nature and meet the capitalization criteria under ASC 340-40. These capitalized costs to fulfill a contract principally relate to upfront direct costs that are expected to be recovered and enhance our ability to satisfy future performance obligations.

The assets related to both costs to obtain and costs to fulfill contracts with clients are capitalized and amortized using an accelerated method to closely align with the pattern of client attrition over the estimated life of the client relationship. Deferred costs to obtain and fulfill contracts are reported in the prepaid expenses and other current assets and long-term deferred costs line items on the Company’s Consolidated Balance Sheets. Amortization expense related to costs to obtain and fulfill a contract are included in operating and selling, general, and administrative expenses in the Company’s Consolidated Statements of Income and Comprehensive Income. The Company regularly reviews its deferred costs and did not recognize an impairment loss during the reporting period.

Changes in deferred costs to obtain and fulfill contracts were as follows:

| | For the three months ended August 31, 2018 | | | |
|---|---|---|---|---|
| In millions | Beginning balance | Capitalization of costs | Amortization | Ending balance |
| Costs to obtain a contract | $ 455.0 | $ 32.4 | $ (38.9) | $ 448.5 |
| Costs to fulfill a contact | $ 65.4 | $ 6.0 | $ (5.7) | $ 65.7 |

Note C: Basic and Diluted Earnings Per Share

Basic and diluted earnings per share were calculated as follows:

| | For the three months ended August 31, | |
|---|---|---|
| In millions, except per share amounts | 2018 | 2017 As Adjusted(1) |
| Basic earnings per share: | | |
| Net income | $ 243.6 | $ 210.4 |
| Weighted-average common shares outstanding | 359.1 | 358.9 |
| Basic earnings per share | $ 0.68 | $ 0.59 |
| Diluted earnings per share: | | |
| Net income | $ 243.6 | $ 210.4 |
| Weighted-average common shares outstanding | 359.1 | 358.9 |
| Dilutive effect of common share equivalents | 2.4 | 2.4 |
| Weighted-average common shares outstanding, assuming dilution | 361.5 | 361.3 |
| Diluted earnings per share | $ 0.67 | $ 0.58 |
| Weighted-average anti-dilutive common share equivalents | 0.3 | 1.1 |

(1) Amounts have been adjusted to reflect the adoption of ASC Topic 606.

Weighted-average common share equivalents that have an anti-dilutive impact are excluded from the computation of diluted earnings per share.

For both the three months ended August 31, 2018 and August 31, 2017, 0.5 million shares of the Company's common stock were issued in connection with the exercise or vesting of stock-based awards. In addition, for the three months ended August 31, 2017, 0.6 million shares of the Company's common stock were issued in relation to an immaterial business acquisition completed in August 2017. Refer to Note D for further details.

Table of Contents

In July 2016, the Company announced that its Board of Directors approved a program to repurchase up to $350.0 million of the Company’s common stock, with authorization expiring in May 2019. The purpose of the program is to manage common stock dilution. During the three months ended August 31, 2018 and August 31, 2017, the Company repurchased 0.5 million shares for $32.8 million and 1.6 million shares for $94.1 million, respectively. All shares of common stock repurchased were retired.

Note D: Business Combinations

Effective February 28, 2018, the Company acquired Lessor Group (“Lessor”). Upon closing, Lessor became a wholly owned subsidiary of the Company. Lessor is a market-leading provider of payroll and HCM software solutions headquartered in Denmark and serving clients in Northern Europe. The purchase price was $162.5 million, net of $13.4 million in cash acquired. Goodwill in the amount of $111.5 million was recorded as a result of the acquisition, which is not tax-deductible. The purchase accounting is provisional and subject to change, pending completion of a final valuation of Lessor. However, further changes to goodwill resulting from the acquisition are not anticipated to be material to the Company’s Consolidated Balance Sheets.

Effective August 18, 2017, the Company acquired HROI and all of its operating subsidiaries. HROI is a national PEO that provides HR solutions to small- and medium-sized businesses in more than 35 states. The acquisition expanded the Company’s presence in the PEO industry. The purchase price was $75.4 million and was comprised of $42.2 million of cash plus $33.2 million issued in the form of Paychex common stock. Goodwill in the amount of $51.1 million was recorded as a result of the acquisition, which is not tax-deductible.

The financial results of both Lessor and HROI are included in the Company’s consolidated financial statements from the respective dates of acquisition. The Company concluded that these acquisitions were not material to its results of operations and financial position. Therefore, pro-forma financial information has been excluded.

Note E: Investment Income, Net

Investment income, net, consisted of the following items:

| In millions | For the three months ended August 31, 2018 | 2017 |
|---|---|---|
| Interest income on corporate funds | $ 3.2 | $ 2.9 |
| Interest expense | (0.9) | (0.8) |
| Investment income, net | $ 2.3 | $ 2.1 |

Note F: Funds Held for Clients and Corporate Investments

Funds held for clients and corporate investments are as follows:

| | August 31, 2018 | | | |
|---|---|---|---|---|
| In millions | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| Type of issue: | | | | |
| Funds held for clients' money market securities and other cash equivalents | $ 1,179.8 | $ — | $ — | $ 1,179.8 |
| Available-for-sale securities: | | | | |
| Corporate bonds | 367.7 | 0.3 | (7.3) | 360.7 |
| General obligation municipal bonds | 1,149.8 | 1.3 | (9.7) | 1,141.4 |
| Pre-refunded municipal bonds(1) | 45.7 | 0.2 | (0.1) | 45.8 |
| Revenue municipal bonds | 767.5 | 1.0 | (7.1) | 761.4 |
| U.S. government agency securities | 454.5 | 0.1 | (14.6) | 440.0 |
| Variable rate demand notes | 162.3 | — | — | 162.3 |
| Total available-for-sale securities | 2,947.5 | 2.9 | (38.8) | 2,911.6 |
| Other | 17.4 | 2.5 | — | 19.9 |
| Total funds held for clients and corporate investments | $ 4,144.7 | $ 5.4 | $ (38.8) | $ 4,111.3 |

Table of Contents

| | May 31, 2018 | | | |
|---|---|---|---|---|
| In millions | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| Type of issue: | | | | |
| Funds held for clients' money market securities and other cash equivalents | $ 1,942.3 | $ — | $ — | $ 1,942.3 |
| Available-for-sale securities: | | | | |
| Corporate bonds | 328.6 | 0.1 | (7.3) | 321.4 |
| General obligation municipal bonds | 1,231.6 | 1.3 | (11.2) | 1,221.7 |
| Pre-refunded municipal bonds(1) | 50.9 | 0.1 | (0.1) | 50.9 |
| Revenue municipal bonds | 813.5 | 0.9 | (8.0) | 806.4 |
| U.S. government agency securities | 410.2 | — | (14.1) | 396.1 |
| Variable rate demand notes | 308.3 | — | — | 308.3 |
| Total available-for-sale securities | 3,143.1 | 2.4 | (40.7) | 3,104.8 |
| Other | 16.1 | 2.1 | — | 18.2 |
| Total funds held for clients and corporate investments | $ 5,101.5 | $ 4.5 | $ (40.7) | $ 5,065.3 |

(1) Pre-refunded municipal bonds are secured by an escrow fund of U.S. government obligations.

Included in money market securities and other cash equivalents as of August 31, 2018 and May 31, 2018 were bank demand deposit accounts, time deposits, commercial paper, and money market funds. In addition, as of August 31, 2018, certain U.S. government agency securities with maturities of 90 days or less at acquisition were also included in money market securities and other cash equivalents.

Classification of investments on the Consolidated Balance Sheets is as follows:

| In millions | August 31, 2018 | May 31, 2018 |
|---|---|---|
| Funds held for clients | $ 3,763.8 | $ 4,703.8 |
| Corporate investments | 82.9 | 66.0 |
| Long-term corporate investments | 264.6 | 295.5 |
| Total funds held for clients and corporate investments | $ 4,111.3 | $ 5,065.3 |

The Company’s available-for-sale securities reflected net unrealized losses of $35.9 million and $38.3 million as of August 31, 2018 and May 31, 2018, respectively. Included in the net unrealized loss totals as of August 31, 2018 and May 31, 2018, were 916 and 970 available-for-sale securities in an unrealized loss position, respectively. The available-for-sale securities in an unrealized loss position were as follows:

| | August 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Securities in an unrealized loss position for less than twelve months | | Securities in an unrealized loss position for more than twelve months | | Total | |
| In millions | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value |
| Type of issue: | | | | | | |
| Corporate bonds | $ (5.8) | $ 272.9 | $ (1.5) | $ 39.7 | $ (7.3) | $ 312.6 |
| General obligation municipal bonds | (7.4) | 745.1 | (2.3) | 64.1 | (9.7) | 809.2 |
| Pre-refunded municipal bonds | (0.1) | 12.8 | — | 0.5 | (0.1) | 13.3 |
| Revenue municipal bonds | (5.2) | 445.1 | (1.9) | 55.6 | (7.1) | 500.7 |
| U.S. government agency securities | (7.0) | 232.8 | (7.6) | 176.7 | (14.6) | 409.5 |
| Total | $ (25.5) | $ 1,708.7 | $ (13.3) | $ 336.6 | $ (38.8) | $ 2,045.3 |

Table of Contents

| | May 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Securities in an unrealized loss position for less than twelve months | | Securities in an unrealized loss position for more than twelve months | | Total | |
| In millions | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value |
| Type of issue: | | | | | | |
| Corporate bonds | $ (6.0) | $ 271.5 | $ (1.3) | $ 34.6 | $ (7.3) | $ 306.1 |
| General obligation municipal bonds | (8.7) | 856.4 | (2.5) | 68.9 | (11.2) | 925.3 |
| Pre-refunded municipal bonds | (0.1) | 18.5 | — | 0.5 | (0.1) | 19.0 |
| Revenue municipal bonds | (6.3) | 540.9 | (1.7) | 50.9 | (8.0) | 591.8 |
| U.S. government agency securities | (6.4) | 219.7 | (7.7) | 176.4 | (14.1) | 396.1 |
| Total | $ (27.5) | $ 1,907.0 | $ (13.2) | $ 331.3 | $ (40.7) | $ 2,238.3 |

The Company regularly reviews its investment portfolios to determine if any investment is other-than-temporarily impaired due to changes in credit risk or other potential valuation concerns. The Company believes that the investments held as of August 31, 2018 that had gross unrealized losses of $38.8 million were not other-than-temporarily impaired. The Company believes that it is probable that the principal and interest will be collected in accordance with contractual terms, and that the unrealized losses on these securities were due to changes in interest rates and were not due to increased credit risk or other valuation concerns. A majority of the securities in an unrealized loss position as of August 31, 2018 and May 31, 2018 held an AA rating or better. The Company does not intend to sell these investments until the recovery of their amortized cost basis or maturity, and further believes that it is not more-likely-than-not that it will be required to sell these investments prior to that time. The Company’s assessment that an investment is not other-than-temporarily impaired could change in the future due to new developments or changes in the Company’s strategies or assumptions related to any particular investment.

Realized gains and losses on the sales of securities are determined by specific identification of the amortized cost basis of each security. On the Consolidated Statements of Income and Comprehensive Income, realized gains and losses from funds held for clients are included in interest on funds held for clients and realized gains and losses from corporate investments are included in investment income, net. Realized gains were insignificant for the three months ended August 31, 2018 and August 31, 2017. There were no realized losses for the three months ended August 31, 2018 and August 31, 2017.

The amortized cost and fair value of available-for-sale securities that had stated maturities as of August 31, 2018 are shown below by contractual maturity. Expected maturities can differ from contractual maturities because borrowers may have the right to prepay obligations without prepayment penalties.

| | August 31, 2018 | |
|---|---|---|
| In millions | Amortized cost | Fair value |
| Maturity date: | | |
| Due in one year or less | $ 382.8 | $ 382.4 |
| Due after one year through three years | 788.0 | 784.6 |
| Due after three years through five years | 979.8 | 965.6 |
| Due after five years | 796.9 | 779.0 |
| Total | $ 2,947.5 | $ 2,911.6 |

Variable rate demand notes are primarily categorized as due after five years in the table above as the contractual maturities on these securities are typically 20 to 30 years. Although these securities are issued as long-term securities, they are priced and traded as short-term instruments because of the liquidity provided through the tender feature.

Table of Contents

Note G: Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The accounting standards related to fair value measurements include a hierarchy for information and valuations used in measuring fair value that is broken down into three levels based on reliability, as follows:

- Level 1 valuations are based on quoted prices in active markets for identical instruments that the Company can access at the measurement date.

- Level 2 valuations are based on inputs other than quoted prices included in Level 1 that are observable for the instrument, either directly or indirectly, for substantially the full term of the asset or liability including the following:

  - quoted prices for similar, but not identical, instruments in active markets;

  - quoted prices for identical or similar instruments in markets that are not active;

  - inputs other than quoted prices that are observable for the instrument; or

  - inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 valuations are based on information that is unobservable and significant to the overall fair value measurement.

The carrying values of cash and cash equivalents, accounts receivable, net of allowance for doubtful accounts, accounts payable and short-term borrowings, when used by the Company, approximate fair value due to the short maturities of these instruments. Marketable securities included in funds held for clients and corporate investments consist primarily of securities classified as available-for-sale and are recorded at fair value on a recurring basis.

The Company’s financial assets and liabilities measured at fair value on a recurring basis were as follows:

| | August 31, 2018 | | | |
|---|---|---|---|---|
| In millions | Carrying value (Fair value) | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Commercial paper | $ 366.9 | $ — | $ 366.9 | $ — |
| Time deposits | 150.0 | — | 150.0 | — |
| U.S. government agency securities | 457.8 | — | 457.8 | — |
| Money market securities | 39.5 | 39.5 | — | — |
| Total cash equivalents | $ 1,014.2 | $ 39.5 | $ 974.7 | $ — |
| Available-for-sale securities: | | | | |
| Corporate bonds | $ 360.7 | $ — | $ 360.7 | $ — |
| General obligation municipal bonds | 1,141.4 | — | 1,141.4 | — |
| Pre-refunded municipal bonds | 45.8 | — | 45.8 | — |
| Revenue municipal bonds | 761.4 | — | 761.4 | — |
| U.S. government agency securities | 440.0 | — | 440.0 | — |
| Variable rate demand notes | 162.3 | — | 162.3 | — |
| Total available-for-sale securities | $ 2,911.6 | $ — | $ 2,911.6 | $ — |
| Other | $ 19.9 | $ 19.9 | $ — | $ — |
| Liabilities: | | | | |
| Other long-term liabilities | $ 19.9 | $ 19.9 | $ — | $ — |

Table of Contents

| In millions | May 31, 2018 Carrying value (Fair value) | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|---|
| Assets: | | | | |
| Cash equivalents: | | | | |
| Commercial paper | $ 655.0 | $ — | $ 655.0 | $ — |
| Time deposits | 200.0 | — | 200.0 | — |
| Money market securities | 7.1 | 7.1 | — | — |
| Total cash equivalents | $ 862.1 | $ 7.1 | $ 855.0 | $ — |
| Available-for-sale securities: | | | | |
| Corporate bonds | $ 321.4 | $ — | $ 321.4 | $ — |
| General obligation municipal bonds | 1,221.7 | — | 1,221.7 | — |
| Pre-refunded municipal bonds | 50.9 | — | 50.9 | — |
| Revenue municipal bonds | 806.4 | — | 806.4 | — |
| U.S. government agency securities | 396.1 | — | 396.1 | — |
| Variable rate demand notes | 308.3 | — | 308.3 | — |
| Total available-for-sale securities | $ 3,104.8 | $ — | $ 3,104.8 | $ — |
| Other | $ 18.2 | $ 18.2 | $ — | $ — |
| Liabilities: | | | | |
| Other long-term liabilities | $ 18.2 | $ 18.2 | $ — | $ — |

In determining the fair value of its assets and liabilities, the Company predominately uses the market approach.  Money market securities, which are cash equivalents, are valued based on quoted market prices in active markets. Cash equivalents also include commercial paper, time deposits, and U.S. government agency securities with a maturity of 90 days or less at acquisition, which are considered Level 2 investments as they are valued based on similar, but not identical, instruments in active markets.  Available-for-sale securities, including municipal bonds, variable rate demand notes, corporate bonds, and U.S. government agency securities, are included in Level 2 and are valued utilizing inputs obtained from an independent pricing service. To determine the fair value of the Company's Level 2 available-for-sale securities, the independent pricing service uses a variety of inputs, including benchmark yields, reported trades, non-binding broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, new issue data, and monthly payment information. The Company has not adjusted the prices obtained from the independent pricing service because it believes that they are appropriately valued.

Assets included as other are mutual fund investments, consisting of participants' eligible deferral contributions under the Company's non-qualified and unfunded deferred compensation plans. The related liability is reported as other long-term liabilities. The mutual funds are valued based on quoted market prices in active markets.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Table of Contents

Note H: Accounts Receivable, Net of Allowance for Doubtful Accounts

The components of accounts receivable, net of allowance for doubtful accounts, consisted of the following:

| In millions | August 31, 2018 | May 31, 2018 As Adjusted(1) |
|---|---|---|
| PEO receivables(2) | $ 166.3 | $ 140.1 |
| Purchased receivables(3) | 295.1 | 267.0 |
| Other trade receivables(4) | 80.1 | 92.3 |
| Total accounts receivable, gross | 541.5 | 499.4 |
| Less: Allowance for doubtful accounts | 6.3 | 7.0 |
| Accounts receivable, net of allowance for doubtful accounts | $ 535.2 | $ 492.4 |

(1) Amounts have been adjusted to reflect the adoption of ASC Topic 606.

(2) PEO receivables are primarily client wages and related tax withholdings since the last payroll processed. Balances will vary based on the timing of the last payroll processed and the end of the reporting period.

(3) Purchased receivables relate to payroll funding arrangements with clients in the temporary staffing industry.

(4) Other trade receivables primarily relate to other ongoing services provided to our clients and can vary based on the timing of these services and the end of the reporting period.

No single client had a material impact on total accounts receivable, service revenue, or results of operations.

Note I: Property and Equipment, Net of Accumulated Depreciation

The components of property and equipment, at cost, consisted of the following:

| In millions | August 31, 2018 | May 31, 2018 |
|---|---|---|
| Land and improvements | $ 10.6 | $ 10.6 |
| Buildings and improvements | 128.0 | 126.4 |
| Data processing equipment | 213.5 | 211.3 |
| Software (1) | 563.8 | 545.5 |
| Furniture, fixtures, and equipment | 111.2 | 114.5 |
| Leasehold improvements | 109.3 | 111.4 |
| Construction in progress (1) | 61.2 | 63.0 |
| Total property and equipment, gross | 1,197.6 | 1,182.7 |
| Less: Accumulated depreciation | 808.5 | 789.2 |
| Property and equipment, net of accumulated depreciation | $ 389.1 | $ 393.5 |

(1) Software includes both purchased software and costs capitalized related to internally developed software placed in service. Capitalized costs related to internally developed software that has not yet been placed in service is included in construction in progress.

Depreciation expense was $29.4 million for the three months ended August 31, 2018, compared to $28.1 million for the three months ended August 31, 2017.

In August 2017, the Company announced its plan for a new multi-building Paychex campus based in Rochester, NY. This involved the purchase of five buildings and the renovation of over 300,000 square feet of existing space. The new campus will result in the consolidation of currently leased space in the Rochester area. The Company completed the purchase of these buildings during the three months ended November 30, 2017 for a combined cost of approximately $34.7 million and placed approximately $16.0 million in escrow for building renovations, which are in-process. As of August 31, 2018 and May 31, 2018, $33.2 million and $32.0 million is included in the Company's construction in progress balance, respectively, with a remaining balance in escrow of $4.4 million and $14.2 million, respectively. In addition, in September 2017, the Company entered into a transaction with the County of Monroe Industrial Development Agency for purposes of obtaining public benefits and inducements, expiring on December 31, 2039. The public inducements include exemption from sales and use taxes for goods and services directly related to the renovations of the new multi-building campus as well as other property tax incentives.

Table of Contents

Note J: Goodwill and Intangible Assets, Net of Accumulated Amortization

The Company had goodwill balances on its Consolidated Balance Sheets of $813.3 million as of August 31, 2018 and $814.0 million as of May 31, 2018.

The Company has certain intangible assets on its Consolidated Balance Sheets. The components of intangible assets, at cost, consisted of the following:

| In millions | August 31, 2018 | May 31, 2018 |
|---|---|---|
| Client lists | $ 307.4 | $ 308.5 |
| Other intangible assets | 13.3 | 13.3 |
| Total intangible assets, gross | 320.7 | 321.8 |
| Less: Accumulated amortization | 185.2 | 180.4 |
| Intangible assets, net of accumulated amortization | $ 135.5 | $ 141.4 |

Amortization expense relating to intangible assets was $6.5 million for the three months ended August 31, 2018, compared to $3.9 million for the three months ended August 31, 2017.

As of August 31, 2018, the estimated amortization expense relating to intangible asset balances for the full year fiscal 2019 and the following four fiscal years is as follows:

| In millions<br>Year ending May 31, | Estimated amortization expense |
|---|---|
| 2019 | $ 26.0 |
| 2020 | 22.6 |
| 2021 | 19.5 |
| 2022 | 16.6 |
| 2023 | 14.2 |

Note K: Accumulated Other Comprehensive (Loss)/Income

The change in unrealized gains and losses, net of applicable taxes, related to investments in available-for-sale securities and foreign currency translation adjustments are the primary components reported in accumulated other comprehensive loss on the Company's Consolidated Balance Sheets.  The changes in accumulated other comprehensive (loss)/income are as follows: