

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Quarterly Report Under Section 13 or 15(d) of
the Securities Exchange Act of 1934

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended August 31, 1996

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

For Quarter Ended August 31, 1996 Commission file number 0-11330

PAYCHEX, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

16-1124166

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

911 PANORAMA TRAIL SOUTH, ROCHESTER, NEW YORK 14625-0397

(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code) (716)385-6666

(Former name, former address and former fiscal year, if
changed since last report.)

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 .

CLASS

OUTSTANDING AT AUGUST 31,1996

(Common Stock, \$.01 Par Value)

(71,674,863 Shares)

PAYCHEX, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION
PAYCHEX, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

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	AUGUST 31, 1996	MAY 31, 1996
	-----	-----
ASSETS	(UNAUDITED)	
	(in thousands)	
<S>	<C>	<C>
CURRENT ASSETS		
CASH AND CASH EQUIVALENTS	\$ 18,920	\$ 19,999
INVESTMENTS	121,208	102,967
INTEREST RECEIVABLE	7,098	7,385
TRADE ACCOUNTS RECEIVABLE	42,470	42,076
PREPAID EXPENSES AND OTHER		
CURRENT ASSETS	2,161	1,903
DEFERRED INCOME TAXES	1,825	1,419
	-----	-----
TOTAL CURRENT ASSETS	193,682	175,749
PROPERTY AND EQUIPMENT		
LAND AND IMPROVEMENTS	2,787	2,787
BUILDINGS	24,244	24,145
DATA PROCESSING EQUIPMENT	44,480	43,439
FURNITURE, FIXTURES AND EQUIPMENT	39,469	37,921
LEASEHOLD IMPROVEMENTS	2,809	2,718
	-----	-----
	113,789	111,010
LESS ALLOWANCE FOR DEPRECIATION AND AMORTIZATION	62,431	60,355
	-----	-----
NET PROPERTY AND EQUIPMENT	51,358	50,655
OTHER ASSETS	5,548	4,945
	-----	-----
TOTAL ASSETS	\$250,588	\$ 231,349
	=====	=====

</TABLE>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

PAYCHEX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS, CONT'D.

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	AUGUST 31, 1996	MAY 31, 1996
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY	(UNAUDITED)	
	(in thousands)	
<S>	<C>	<C>
CURRENT LIABILITIES		
TRADE ACCOUNTS PAYABLE	\$ 3,429	\$ 4,183
ACCRUED COMPENSATION AND RELATED ITEMS	18,917	19,120
RESERVE FOR WORKERS' COMPENSATION	1,269	1,235
ACCRUED INCOME TAXES	7,386	573
OTHER ACCRUED EXPENSES	7,207	5,941
DEFERRED REVENUE	4,053	4,934
	-----	-----
TOTAL CURRENT LIABILITIES	42,261	35,986
OTHER LIABILITIES		
DEFERRED INCOME TAXES	249	416
RESERVE FOR WORKERS' COMPENSATION	865	865
CUSTOMER DEPOSITS	1,155	1,038
OTHER LONG-TERM LIABILITIES	1,096	848
	-----	-----

TOTAL LIABILITIES	45,626	39,153
STOCKHOLDERS' EQUITY		
COMMON STOCK, \$.01 PAR VALUE, AUTHORIZED 150,000,000 SHARES: ISSUED 71,674,863 AT AUGUST 31, 1996 AND 71,632,456 AT MAY 31, 1996	717	716
ADDITIONAL CAPITAL	30,354	30,112
RETAINED EARNINGS	173,891	161,368
	-----	-----
	204,962	192,196
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$250,588	\$ 231,349
	=====	=====

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SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
PAYCHEX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

<TABLE>

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	THREE MONTHS ENDED AUGUST 31,	
	1996	1995
	----	----
	(in thousands, except per share amounts)	
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PAYROLL REVENUE	\$ 88,927	\$ 76,173
PEO REVENUE	77,115	47,314
	-----	-----
TOTAL REVENUE	\$166,042	\$123,487
	-----	-----
PEO DIRECT COSTS	74,769	45,628
OPERATING COSTS	26,564	23,375
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	42,612	38,201
	-----	-----
OPERATING INCOME	22,097	16,283
OTHER INCOME	1,485	1,386
	-----	-----
INCOME BEFORE INCOME TAXES	23,582	17,669
INCOME TAXES	6,509	4,888
	-----	-----
NET INCOME	\$17,073	\$12,781
	=====	=====
EARNINGS PER SHARE	\$.24	\$.18
	=====	=====
CASH DIVIDENDS PER SHARE	\$.06	\$.04
	=====	=====
WEIGHTED AVERAGE SHARES OUTSTANDING	71,653	71,003
	=====	=====

</TABLE>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
PAYCHEX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

<TABLE>

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	THREE MONTHS ENDED AUGUST 31,	
	1996	1995
	----	----
	(in thousands)	
<S>	<C>	<C>
OPERATING ACTIVITIES		
NET INCOME	\$17,073	\$ 12,781
ADJUSTMENTS TO RECONCILE NET INCOME		

TO CASH PROVIDED BY OPERATING ACTIVITIES:		
DEPRECIATION AND AMORTIZATION	3,651	3,550
NET CHANGE IN DEFERRED INCOME TAXES	(649)	161
PROVISION FOR BAD DEBTS	368	316
NET REALIZED GAIN ON SALES OF AVAILABLE-FOR-SALE SECURITIES	(29)	(251)
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
TRADE ACCOUNTS RECEIVABLE	(762)	(1,864)
ACCRUED INTEREST RECEIVABLE	287	480
PREPAID EXPENSES AND OTHER CURRENT ASSETS	(258)	(746)
TRADE ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES	7,122	4,382
DEFERRED REVENUE	(881)	(729)
RESERVE FOR WORKERS' COMPENSATION	34	317
CUSTOMER DEPOSITS	117	97
	-----	-----
NET CASH PROVIDED BY OPERATING ACTIVITIES	26,073	18,494
INVESTING ACTIVITIES		
INVESTMENT PURCHASES OF AVAILABLE- FOR-SALE SECURITIES	(25,340)	(30,853)
PROCEEDS FROM SALES OF AVAILABLE- FOR-SALE SECURITIES	7,297	18,457
PROCEEDS FROM MATURITIES OF AVAILABLE- FOR-SALE SECURITIES	-0-	2,250
ADDITIONS TO PROPERTY AND EQUIPMENT, NET OF DISPOSALS	(4,178)	(4,998)
NET CHANGE IN OTHER ASSETS	(780)	(526)
	-----	-----
NET CASH USED IN INVESTING ACTIVITIES	(23,001)	(15,670)
FINANCING ACTIVITIES		
PROCEEDS AND TAX BENEFIT FROM EXERCISE OF STOCK OPTIONS	244	334
DIVIDENDS PAID	(4,643)	(2,756)
OTHER	248	12
	-----	-----
NET CASH USED IN FINANCING ACTIVITIES	(4,151)	(2,410)
	-----	-----
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	(1,079)	414
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		
	19,999	14,812
CASH OBTAINED FROM PAY-FONE ACQUISITION		
	-0-	805
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD		
	\$ 18,920	\$ 16,031
	=====	=====

</TABLE>

SEE NOTES TO FINANCIAL STATEMENTS
PAYCHEX, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

AUGUST 31, 1996

- A) THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS OF PAYCHEX, INC. AND ITS WHOLLY-OWNED SUBSIDIARIES HAVE BEEN PREPARED IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR INTERIM FINANCIAL INFORMATION AND WITH THE INSTRUCTIONS TO FORM 10-Q AND ARTICLE 10 OF REGULATION S-X. ACCORDINGLY, THE CONSOLIDATED FINANCIAL STATEMENTS DO NOT INCLUDE ALL OF THE INFORMATION AND FOOTNOTES REQUIRED BY GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR COMPLETE FINANCIAL STATEMENTS. IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS CONSIDERED NECESSARY FOR A FAIR PRESENTATION HAVE BEEN INCLUDED. THE ACCOMPANYING FINANCIAL STATEMENTS SHOULD BE READ IN CONJUNCTION WITH THE NOTES TO FINANCIAL STATEMENTS PRESENTED IN THE COMPANY'S FORM 10-K AND ANNUAL REPORT FOR THE YEAR ENDED MAY 31, 1996.
- B) DURING THE THREE-MONTH PERIOD ENDING AUGUST 31, 1996, 42,407 SHARES OF STOCK WERE ISSUED UPON EXERCISE OF STOCK OPTIONS.
- C) ON AUGUST 26, 1996, THE COMPANY COMPLETED ITS MERGER WITH NATIONAL BUSINESS SOLUTIONS, INC. (NBS), NOW PAYCHEX BUSINESS SOLUTIONS, INC. (PBS) A PROFESSIONAL EMPLOYER ORGANIZATION, HEADQUARTERED IN ST. PETERSBURG, FLORIDA. THE OUTSTANDING COMMON STOCK OF NBS WAS EXCHANGED FOR 2,934,496 SHARES OF PAYCHEX COMMON STOCK, VALUED AT \$140,000,000. THE TRANSACTION WAS ACCOUNTED FOR AS A POOLING OF INTERESTS; THEREFORE, PRIOR PERIOD FINANCIAL STATEMENTS HAVE BEEN RESTATED TO REFLECT THIS MERGER.

PBS IS A LEADING PROFESSIONAL EMPLOYER ORGANIZATION ("PEO"), WHICH

PROVIDES SMALL AND MEDIUM-SIZED BUSINESSES WITH AN OUTSOURCING SOLUTION TO THE COMPLEXITIES AND COSTS RELATED TO EMPLOYMENT AND HUMAN RESOURCES.

D) ON AUGUST 29, 1996, THE COMPANY ACQUIRED ALL OF THE OUTSTANDING STOCK OF THE PAYROLL SERVICE, INC., IN EXCHANGE FOR APPROXIMATELY 55,000 SHARES OF PAYCHEX COMMON STOCK IN A BUSINESS COMBINATION ACCOUNTED FOR AS A POOLING OF INTERESTS. RESULTS OF OPERATIONS PRIOR TO THE MERGER HAVE NOT BEEN RESTATED AS THE EFFECTS WOULD BE IMMATERIAL.

E) CERTAIN AMOUNTS FROM THE PRIOR YEAR ARE RECLASSIFIED TO CONFORM TO FISCAL 1997 PRESENTATIONS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED), CONT'D.

NOTE F - SEGMENT INFORMATION

THE COMPANY OPERATES IN TWO MAJOR SEGMENTS, PAYROLL AND PROFESSIONAL EMPLOYER ORGANIZATION (PEO). THE PAYROLL SEGMENT IS ENGAGED IN THE PREPARATION OF PAYROLL CHECKS, INTERNAL ACCOUNTING RECORDS AND ALL FEDERAL, STATE AND LOCAL PAYROLL TAX RETURNS FOR SMALL TO MEDIUM-SIZED BUSINESSES. THE PEO SEGMENT SPECIALIZES IN PROVIDING SMALL AND MEDIUM-SIZED BUSINESSES WITH COST-EFFECTIVE OUTSOURCING SOLUTIONS FOR THEIR EMPLOYEE BENEFITS. AS AN OUTSOURCING SOLUTION, THE PEO RELIEVES THE BUSINESS OWNER OF HUMAN RESOURCES ADMINISTRATION, EMPLOYMENT REGULATORY COMPLIANCE, WORKERS' COMPENSATION COVERAGE, HEALTH CARE AND OTHER EMPLOYEE RELATED RESPONSIBILITIES. CONSISTENT WITH PEO INDUSTRY PRACTICE, REVENUE INCLUDES ALL AMOUNTS BE BILLED TO CLIENTS FOR THE SERVICES PROVIDED BY THE PEO.

<TABLE>
<CAPTION>

	1996	1995

FOR THE THREE MONTHS ENDED AUGUST 31, (in thousands, except per share amounts)		

<S>		
REVENUE	<C>	<C>
PAYROLL	\$ 88,927	\$ 76,173
PEO	77,115	47,314
	-----	-----
TOTAL REVENUE	166,042	123,487
PEO DIRECT COSTS	74,769	45,628
	-----	-----
REVENUE, LESS PEO DIRECT COSTS	91,273	77,859
OPERATING COSTS		
PAYROLL	25,256	22,384
PEO	1,308	991
	-----	-----
TOTAL OPERATING COSTS	26,564	23,375
SELLING, GENERAL AND ADMIN		
PAYROLL	40,879	36,705
PEO	237	171
	-----	-----
TOTAL SELLING, GENERAL AND ADMIN	41,116	36,876
OPERATING INCOME		
PAYROLL	22,792	17,084
PEO	801	524
	-----	-----
TOTAL OPERATING INCOME	23,593	17,608
GENERAL CORPORATE EXPENSES	1,496	1,325
OTHER INCOME - NET	1,485	1,386
	-----	-----
INCOME BEFORE TAXES	\$ 23,582	\$ 17,669
	=====	=====

</TABLE>

PAYCHEX, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis reviews the Company's operating results for the quarter ended August 31, 1996 and 1995, and its financial condition at August 31, 1996. The focus of this review is on the underlying business reasons for significant changes and trends affecting revenues, net income, and financial condition. This review should be read in conjunction with the May 31, 1996 Consolidated Financial Statements, and the related Notes to Consolidated Financial Statements, as well as Form 8-K filed on July 9, 1996 which contained audited financial statements of National Business Solutions, Inc., discussed below. Forward-looking statements in this management's discussion and analysis are qualified by the cautionary statement at the end of this discussion.

Results of operations for 1995 and 1996 have been restated to reflect Paychex' August 26, 1996 merger with National Business Solutions, Inc. (NBS) now Paychex Business Solutions, Inc. (PBS), a Professional Employer Organization (PEO) headquartered in St. Petersburg, Florida. The transaction was accounted for as a pooling of interests.

Results of Operations

Paychex earned a record consolidated net income of \$17.1 million or \$.24 per share for the first quarter ended August 31, 1996, up 34% over consolidated net income of \$12.8 million or \$.18 per share for the same quarter last year. Consolidated revenue reached \$166.0 million, an increase of 34% over \$123.5 million for the same period last year. First quarter results included approximately \$0.5 million of merger costs associated with the acquisition of NBS.

Payroll Segment

Payroll service revenue for the first quarter ended August 31, 1996 rose 17% to a record \$88.9 million, up from \$76.2 million for the same quarter last year. The gain resulted primarily from clients utilizing the basic payroll service as well as clients using Taxpay and Direct Deposit products. Strong revenue gains were also achieved from the Human Resource Services Division. During the quarter the percentage of the client base using Taxpay increased from 56% to 59% as the Company began to benefit from the Federal mandate requiring small businesses to file payroll taxes electronically as of July 1, 1997.

Paychex currently serves almost 240,000 payroll clients, with approximately 141,500 utilizing Taxpay and approximately 56,000 clients taking advantage of Direct Deposit for their employees. The Company expects continued increases in revenue for all products and services throughout the year.

Operating costs were 28% of revenue for the first quarter, down from 29% for the same period last year. Most of the decrease resulted from lower costs, as a percentage of revenue, associated with delivery, forms and supplies and equipment maintenance. Full year operating costs, as a percentage of revenue, are expected to be slightly lower than last year.

Selling, general and administrative expenses were 46% of revenue at August 31, 1996, down from 48% in last year's first quarter. As a percentage of revenue, administrative payroll and sales wages were lower in the current quarter versus the same period last year. Selling, general and administrative expenses, as a percentage of revenue, have been decreasing over the past few years, and the Company expects this trend to continue in fiscal 1997.

PEO Segment

PBS, a professional employer organization, specializes in providing small and medium-sized businesses with cost-effective outsourcing solutions for their employee benefits. As an outsourcing solution, PBS relieves the business owner of human resources administration, employment regulatory compliance, workers' compensation coverage, health care, 401(k) administration and other employee related responsibilities.

For the quarter ended August 31, 1996, PBS gross revenue rose 63% to a record \$77.1 million from \$47.3 million in the same quarter last year. Operating income from the PEO business increased 53% to \$0.8 million from \$0.5 million in the same quarter last year. Growth in revenues and operating income resulted from strong increases in the number of clients and worksite employees.

PBS has started to offer the PEO services to Paychex payroll clients in Florida and plans to expand to other select locations.

PBS currently serves over 230 clients, representing in excess of 9,600 work site employees. The client base and worksite employees are expected to continue to grow as PBS expands the offering of its PEO services to existing payroll clients.

Liquidity and Capital Resources

Net cash provided by consolidated operating activities totaled \$26.1 million for the first quarter of 1997 as compared to \$18.5 million in 1996. Net income for the current quarter contributed a record \$17.1 million, representing a 34% gain over net income of \$12.8 million achieved the same quarter last year.

Company owned investments and investments of client funds held for Taxpay and Direct Deposit consist of municipal securities issued by various governmental agencies and short-term money market securities. At August 31, 1996, the total Taxpay and Direct Deposit funds held by the Company were \$606.3 million. The Company continues to control credit and market risks by investing primarily in AAA and AA rated municipal securities, limiting amounts that can be invested in any single instrument, and investing in

short-to intermediate-term instruments which limit sensitivity to interest rate changes.

Proceeds from sales of securities during the current quarter were significantly lower than the comparable period last year when the Company managed its investment portfolio to realize gains and minimize risk associated with market interest rates that were declining at that time. Capital expenditures for the first quarter totalled \$4.7 million. In addition, the Company began its planned upgrade of laser printing equipment in branch offices through five year operating leases. Capital expenditures for the remainder of the year are estimated to range between \$11 million to \$17 million.

Projected cash flows are expected to be adequate to support normal business operations, planned capital expenditures and dividend payments. Furthermore, the Company has \$200 million of unsecured bank lines of credit available for its use. As of August 31, 1996, there were no outstanding borrowings under these lines of credit.

Other

In an effort to give investors a well-rounded view of the Company's current condition and future opportunities, this Form 10-Q includes comments by the Company's management about future performance and results. Because they are forward-looking, these forecasts involve uncertainties. They include risks of general market conditions, including demand for the Company's products and services, competition, and price levels; changes in the laws regulating collection and payment of payroll taxes and employee benefits, including 401(k) plans and Section 125 plans; delays in the development and marketing of new products and services; the possibility of catastrophic events that could impact the Company's operating facilities, computer technology, and communication systems; changes in short-and long-term interest rates and the credit rating of municipal securities held in the Company's investment portfolios.

PART II. OTHER INFORMATION

PAYCHEX, INC. AND SUBSIDIARIES

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS:

THERE WERE NO EXHIBITS APPLICABLE FOR THE THREE MONTH PERIOD ENDED AUGUST 31, 1996.

(B) REPORTS ON FORM 8-K:

ON JULY 9, 1996, THE COMPANY FILED A FORM 8-K ANNOUNCING THAT ON JUNE 25, 1996, THE COMPANY REACHED AN AGREEMENT TO MERGE WITH NATIONAL BUSINESS SOLUTIONS, INC. (NBS), HEADQUARTERED IN ST. PETERSBURG, FLORIDA. THE MERGER WAS ACCOUNTED FOR AS A POOLING OF INTERESTS AND WAS CONSUMATED ON AUGUST 26, 1996. SEE FOOTNOTE (C) ON PAGE 8 FOR FURTHER DETAILS.

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THE REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED THEREUNTO DULY AUTHORIZED.

PAYCHEX, INC. AND SUBSIDIARIES

DATE: OCTOBER 14, 1996

/s/ B. THOMAS GOLISANO

B. THOMAS GOLISANO
CHAIRMAN, PRESIDENT AND CHIEF
EXECUTIVE OFFICER

DATE: OCTOBER 14, 1996

/s/ JOHN M. MORPHY

JOHN MORPHY
VICE PRESIDENT OF FINANCE

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE AUGUST 31, 1996 FINANCIAL STATEMENTS OF PAYCHEX, INC. AND SUBSIDIARIES AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

</LEGEND>

<CIK> 0000723531

<NAME> PAYCHEX, INC.

<MULTIPLIER> 1,000

<CURRENCY> US

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