Table of Contents

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

FOR THE QUARTERLY PERIOD ENDED FEBRUARY 28, 2002
OR
( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

COMMISSION FILE NUMBER 0-11330

PAYCHEX, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	16-1124166 (I.R.S. Employer Identification No.)
911 PANORAMA TRAIL SOUTH, ROCHESTER, NEW YORK (Address of principal executive offices)	14625-0397 (Zip Code)

(585) 385-6666
(Registrant's telephone number, including area code)

(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[X] No[ ].

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, $.01 Par Value	375,102,172 Shares
CLASS	OUTSTANDING AT FEBRUARY 28, 2002

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In thousands, except per share amounts)

	For the three months ended		For the nine months ended	
	February 28, 2002	February 28, 2001	February 28, 2002	February 28, 2001
Revenues:				
Service revenues	$ 227,964	$ 203,351	$ 661,649	$ 580,566
Interest on funds held for clients	14,836	25,905	48,953	60,671
Total revenues	**242,800**	**229,256**	**710,602**	**641,237**
Operating costs	56,739	54,376	165,226	147,398
Selling, general and administrative expenses	98,844	87,998	273,314	244,706
Operating income	**87,217**	**86,882**	**272,062**	**249,133**
Investment income, net	8,427	7,234	24,145	18,733
Income before income taxes	**95,644**	**94,116**	**296,207**	**267,866**
Income taxes	28,671	27,764	90,343	80,758
Net income	**$ 66,973**	**$ 66,352**	**$ 205,864**	**$ 187,108**
Basic earnings per share	**$ .18**	**$ .18**	**$ .55**	**$ .50**
Diluted earnings per share	**$ .18**	**$ .18**	**$ .54**	**$ .50**
Weighted-average common shares outstanding	**374,922**	**373,057**	**374,460**	**372,560**
Weighted-average shares assuming dilution	**378,096**	**377,681**	**377,809**	**377,558**
Cash dividends per common share	**$ .11**	**$ .09**	**$ .31**	**$ .24**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	February 28, 2002 (Unaudited)	May 31, 2001 (Audited)
ASSETS		
Cash and cash equivalents	$ 159,595	$ 45,784
Corporate investments	600,499	568,217
Interest receivable	20,402	28,281
Accounts receivable	86,424	100,640
Prepaid expenses and other current assets	10,204	7,306
Current assets before funds held for clients	**877,124**	**750,228**
Funds held for clients	2,271,964	2,041,045
Total current assets	**3,149,088**	**2,791,273**
Property and equipment – net	106,914	96,078
Intangible assets – net	8,852	9,612
Deferred income taxes	1,247	1,361
Other assets	8,934	8,872
Total assets	**$3,275,035**	**$2,907,196**
LIABILITIES		
Accounts payable	$ 15,056	$ 16,377
Accrued compensation and related items	64,142	57,418
Deferred revenue	5,189	4,421
Accrued income taxes	21,275	9,783
Deferred income taxes	7,629	4,996
Other current liabilities	16,271	19,282
Current liabilities before client fund deposits	**129,562**	**112,277**
Client fund deposits	2,255,740	2,031,565
Total current liabilities	**2,385,302**	**2,143,842**
Long-term liabilities	5,435	5,512
Total liabilities	**2,390,737**	**2,149,354**
STOCKHOLDERS' EQUITY		
Common stock, $.01 par value, 600,000 authorized shares Issued: 375,102 at February 28, 2002 and 373,647 at May 31, 2001	3,751	3,736
Additional paid-in capital	169,143	139,897
Retained earnings	690,865	601,142
Accumulated other comprehensive income	20,539	13,067
Total stockholders' equity	**884,298**	**757,842**
Total liabilities and stockholders' equity	**$3,275,035**	**$2,907,196**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	For the nine months ended	
	February 28, 2002	**February 28, 2001**
OPERATING ACTIVITIES		
Net income	$ 205,864	$ 187,108
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization on depreciable and intangible assets	21,867	19,344
Amortization of premiums and discounts on available-for-sale securities	12,563	9,183
Provision for deferred income taxes	(1,406)	(1,413)
Tax benefit related to exercise of stock options	15,450	23,065
Provision for bad debts	974	968
Net realized gains on sales of available-for-sale securities	(12,818)	(3,531)
Changes in operating assets and liabilities:		
Interest receivable	7,879	2,263
Accounts receivable	13,242	(3,258)
Prepaid expenses and other current assets	(2,898)	(1,654)
Accounts payable and other current liabilities	16,668	24,005
Net change in other assets and liabilities	(37)	159
Net cash provided by operating activities	**277,348**	**256,239**
INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(854,121)	(543,624)
Proceeds from sales of available-for-sale securities	722,844	398,188
Proceeds from maturities of available-for-sale securities	41,594	17,230
Net change in funds held for clients' money market securities and other cash equivalents	(161,733)	6,754
Net change in client fund deposits	224,175	38,553
Purchases of property and equipment	(32,708)	(28,971)
Proceeds from sale of property and equipment	10	41
Purchases of other assets	(1,268)	(6,773)
Net cash used in investing activities	**(61,207)**	**(118,602)**
FINANCING ACTIVITIES		
Dividends paid	(116,141)	(89,457)
Proceeds from exercise of stock options	13,811	11,480
Net cash used in financing activities	**(102,330)**	**(77,977)**
Increase in cash and cash equivalents	**113,811**	**59,660**
Cash and cash equivalents, beginning of period	45,784	47,136
Cash and cash equivalents, end of period	**$ 159,595**	**$ 106,796**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
February 28, 2002

Note A: Significant Accounting Policies

The accompanying 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, the information furnished herein reflects all adjustments (consisting of items of a normal recurring nature) which are necessary for a fair presentation of the results for the interim period. Operating results for the nine months ended February 28, 2002 are not necessarily indicative of the results that may be expected for the full year ended May 31, 2002.

Service revenues are recognized in the period services are rendered and earned. PEO revenues are included in service revenues and are reported net of direct costs billed and incurred. Direct costs billed and incurred include wages, taxes, benefit premiums and claims of worksite employees and totaled $282.8 million and $238.1 million for the three months ended February 28, 2002 and 2001, respectively, and $764.8 million and $640.0 million for the nine months ended February 28, 2002 and 2001, respectively. Paychex provides delivery service for many of its clients' payrolls. The revenue earned from delivery service is included in service revenues and the costs for the delivery are included in operating costs on the Consolidated Statements of Income.

Interest on funds held for clients is earned on Taxpay® and Employee Pay Services funds that are collected before due dates and invested (funds held for clients) until remittance to the applicable tax authorities for Taxpay clients and employees of Employee Pay Services clients. These collections from clients are typically remitted between one and thirty days after receipt, with some items extending to ninety days. The interest earned on these funds is included in total revenues on the Consolidated Statements of Income as the collection, holding and remittance of these funds is a critical component of providing these particular product services. Interest on funds held for clients also includes net realized gains and losses from the sale of available-for-sale securities.

There is no significant seasonality to the Company's business. However, during the third fiscal quarter, the number of new Payroll clients, Retirement Services clients and new PAS and PEO worksite employees tends to be higher than the rest of the fiscal year. Consequently, greater sales commission expenses are reported in the third quarter.

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard 141, "Business Combinations" (SFAS No. 141) and Statement of Financial Accounting Standard 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 141 requires that all future business combinations be accounted for using the purchase method of accounting and the use of the pooling-of-interest method is prohibited for transactions initiated after July 1, 2001. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. This statement recognizes that goodwill has an indefinite useful life and will no longer be subject to periodic amortization, but rather periodically evaluated for impairment. The statement also requires an evaluation of existing acquired goodwill and other intangible assets for proper classification under the new requirements. The Company adopted these standards in the first quarter of fiscal 2002. Adoption of these standards did not have a material impact on the results of operations or financial position of the Company.

In August 2001, the FASB issued SFAS No. 143, “Accounting for Asset Retirement Obligations,” which requires companies to record a liability at fair value for asset retirement obligations in the period in which they are incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This Statement is effective for the Company for the fiscal year beginning June 1, 2003. The Company is currently evaluating the provisions of this Statement, but does not believe adoption of this Statement will result in a material impact to its results of operations or financial position.

In October 2001, the FASB issued SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” which provides a single accounting model for long-lived assets to be disposed of. This Statement is effective for the Company for the fiscal year beginning June 1, 2002. The Company is currently evaluating the provisions of this statement, but does not anticipate that adoption will result in a material impact to its results of operations or financial position.

The accompanying Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related Notes presented in the Company’s Annual Report on Form 10-K for the year ended May 31, 2001. Certain amounts from the prior year have been reclassified to conform to the current year presentation.

Note B: Segment Financial Information

The Company is a national provider of payroll, human resource and employee benefits outsourcing solutions for small- to medium-sized businesses in the United States.

During the second half of fiscal 2001, the Company completed consolidation efforts to streamline certain operations and improve customer service. These efforts resulted in certain service operations supporting multiple products for both Payroll and Human Resource and Benefits product lines. Due to these changes, the Company no longer prepares internal reporting reflecting the operating results of the Payroll and Human Resource and Benefits segments. As a result, in fiscal 2002, the Company changed its segment reporting from two segments to one segment based upon the provisions of SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information.”

Note C: Basic and Diluted Earnings Per Share

Basic and diluted earnings per share were calculated as follows:

(In thousands, except per share amounts)	For the three months ended February 28, 2002	For the three months ended February 28, 2001	For the nine months ended February 28, 2002	For the nine months ended February 28, 2001
Basic earnings per share:				
Net income	$ 66,973	$ 66,352	$ 205,864	$ 187,108
Weighted-average common shares outstanding	374,922	373,057	374,460	372,560
Basic earnings per share	$ .18	$ .18	$ .55	$ .50
Diluted earnings per share:				
Net income	$ 66,973	$ 66,352	$ 205,864	$ 187,108
Weighted-average common shares outstanding	374,922	373,057	374,460	372,560
Net effect of dilutive stock options at average market prices	3,174	4,624	3,349	4,998
Weighted-average shares assuming dilution	378,096	377,681	377,809	377,558
Diluted earnings per share	$ .18	$ .18	$ .54	$ .50
Weighted-average anti-dilutive stock options	1,365	261	1,500	221

Weighted-average anti-dilutive stock options to purchase shares of common stock were excluded from the computation of diluted earnings per share. These options had an exercise price that was greater than the average market price of the common shares for the period; therefore, the effect would have been anti-dilutive.

For the three and nine months ended February 28, 2002, stock options were exercised for 362,000 and 1,455,000 shares of the Company's common stock, respectively, compared with 413,000 and 1,554,000 for the prior year periods.

Note D: Funds Held for Clients and Corporate Investments

	February 28, 2002 (Unaudited)		May 31, 2001 (Audited)	
(In thousands)	Cost	Fair value	Cost	Fair value
Type of Issue:				
Money market securities and other cash equivalents	$1,428,431	$1,428,431	$1,266,698	$1,266,698
Available-for-sale securities:				
General obligation municipal bonds	740,226	756,272	582,249	590,806
Pre-refunded municipal bonds	237,326	243,506	293,109	298,058
Revenue municipal bonds	431,410	441,282	443,667	450,635
Other securities	20	65	20	64
Total available-for-sale securities	1,408,982	1,441,125	1,319,045	1,339,563
Other	3,213	2,907	3,099	3,001
Total funds held for clients and corporate investments	**$2,840,626**	**$2,872,463**	**$2,588,842**	**$2,609,262**
Classification of investments on the Consolidated Balance Sheets:				
Funds held for clients	$2,255,740	$2,271,964	$2,031,565	$2,041,045
Corporate investments	584,886	600,499	557,277	568,217
Total funds held for clients and corporate investments	**$2,840,626**	**$2,872,463**	**$2,588,842**	**$2,609,262**

The Company is exposed to credit risk from the possible inability of the borrowers to meet the terms of their bonds. In addition, the Company is exposed to interest rate risk as rate volatility will cause fluctuations in the market value of held investments and the earnings potential of future investments. The Company attempts to limit these risks by investing primarily in AAA and AA rated securities and A-1 rated short-term securities, limiting amounts that can be invested in any single instrument, and by investing in short- to intermediate-term instruments whose market value is less sensitive to interest rate changes. At February 28, 2002, approximately 98% of the available-for-sale bond securities held an AA rating or better, and all short-term securities classified as cash equivalents held an A-1 or equivalent rating. The Company does not utilize derivative financial instruments to manage interest rate risk, and, therefore, adopting Statement of Financial Accounting Standards No. 133 “Accounting for Derivative Instruments and Hedging Activities” had no impact on the results of operations or financial condition of the Company for the first nine months of fiscal 2002.

Note E: Property and Equipment — Net

(In thousands)	February 28, 2002 (Unaudited)	May 31, 2001 (Audited)
Land and improvements	$ 3,040	$ 2,919
Buildings and improvements	35,653	36,923
Data processing equipment and software	127,322	106,359
Furniture, fixtures and equipment	80,569	75,243
Leasehold improvements	14,927	12,545
	261,511	233,989
Less: accumulated depreciation and amortization	154,597	137,911
Property and equipment – net	**$ 106,914**	**$ 96,078**

Note F: Comprehensive Income

Comprehensive income is comprised of two components: net income and other comprehensive income. Comprehensive income includes all changes in equity during a period except those resulting from transactions with owners of the Company. The unrealized gains and losses, net of applicable taxes, related to available-for-sale securities is the only component reported in accumulated other comprehensive income in the Consolidated Balance Sheets for the Company. Comprehensive income, net of related tax effects, is as follows:

	For the three months ended		For the nine months ended	
(In thousands)	February 28, 2002	February 28, 2001	February 28, 2002	February 28, 2001
Net income	$ 66,973	$ 66,352	$ 205,864	$ 187,108
Unrealized gains on securities, net of reclassification adjustments	4,394	11,039	7,472	21,806
Total comprehensive income	$ 71,367	$ 77,391	$ 213,336	$ 208,914

Note G: Related Party Transactions

During fiscal 2002, the Company has purchased approximately $11.2 million of data processing equipment and software from EMC Corporation. The President and Chief Executive Officer of EMC Corporation is a member of the Board of Directors of Paychex.

Table of Contents

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

Management's Discussion and Analysis of Financial Condition and Results of Operations reviews the operating results for the three months and nine months ended February 28, 2002 (fiscal 2002) and 2001 (fiscal 2001), and the financial condition at February 28, 2002 for Paychex, Inc. and its subsidiaries (the "Company"). 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 accompanying February 28, 2002 Consolidated Financial Statements and the related Notes to Consolidated Financial Statements contained in this Form 10-Q. Forward-looking statements in this review are qualified by the cautionary statement included in the "Other" section of this review under the sub-heading "Safe-Harbor Statement under the Private Securities Litigation Reform Act of 1995."

RESULTS OF OPERATIONS

For the first nine months of fiscal 2002, the Company generated record total revenues, net income and diluted earnings per share. The results for the third quarter and nine-month periods of fiscal 2002 have been affected by the recessionary U.S. economic conditions.

(In thousands, except per share amounts) For the three months ended February 28,	2002	Change	2001	Change
Revenues:				
Payroll	$195,762	10.1%	$177,842	14.4%
Human Resource and Benefits	32,202	26.2%	25,509	25.3%
Total service revenues	227,964	12.1%	203,351	15.7%
Interest on funds held for clients	14,836	-42.7%	25,905	58.4%
Total revenues	242,800	5.9%	229,256	19.3%
Combined operating and SG&A expenses	155,583	9.3%	142,374	14.6%
Operating income	87,217	0.4%	86,882	28.0%
Investment income, net	8,427	16.5%	7,234	80.3%
Income before income taxes	95,644	1.6%	94,116	30.9%
Income taxes	28,671	3.3%	27,764	24.5%
Net income	$ 66,973	0.9%	$ 66,352	33.7%
Diluted earnings per share	$ .18	—	$ .18	38.5%
Operating income as a % of total revenues	35.9%		37.9%	
Income before income taxes as a % of total revenues	39.4%		41.1%	
Net income as a % of total revenues	27.6%		28.9%	

(In thousands, except per share amounts) For the nine months ended February 28,	2002	Change	2001	Change
Revenues:				
Payroll	$573,683	12.6%	$509,496	16.6%
Human Resource and Benefits	87,966	23.8%	71,070	33.4%
Total service revenues	661,649	14.0%	580,566	18.4%
Interest on funds held for clients	48,953	-19.3%	60,671	49.5%
Total revenues	710,602	10.8%	641,237	20.8%
Combined operating and SG&A expenses	438,540	11.8%	392,104	14.7%
Operating income	272,062	9.2%	249,133	31.8%
Investment income, net	24,145	28.9%	18,733	62.1%
Income before income taxes	296,207	10.6%	267,866	33.5%
Income taxes	90,343	11.9%	80,758	29.8%
Net income	$205,864	10.0%	$187,108	35.1%
Diluted earnings per share	$ .54	8.0%	$ .50	35.1%
Operating income as a % of total revenues	38.3%		38.9%	
Income before income taxes as a % of total revenues	41.7%		41.8%	
Net income as a % of total revenues	29.0%		29.2%	

Total revenues are comprised of service revenues and interest on funds held for clients. Total service revenues are comprised of the Payroll and Human Resource and Benefits product lines. Payroll service revenues are earned primarily from Payroll, Taxpay, Employee Pay Services and other ancillary services. Employee Pay Services include the Direct Deposit, Readychex^{SM} and Access Card products.

The increases in Payroll service revenues in fiscal 2002 compared with the prior year are attributable to the addition of new clients, new services, price increases and increased utilization of ancillary services by both new and existing clients. As of February 28, 2002, 84% of Paychex clients utilized Taxpay, the Company's tax filing and payment feature, compared with 83% utilization at February 28, 2001. Client utilization of the Taxpay product is expected to mature in the range of 84% to 87%. The Company's Employee Pay Services were utilized by 56% of its clients at February 28, 2002 compared with 52% utilization at February 28, 2001. Major Market Services revenue increased 40% and 51% for the third quarter and nine-month periods to $19.3 million and $51.5 million, respectively. Approximately one-third of new Major Market Services clients are conversions from the Company's Core Payroll service.

The increases in Human Resource and Benefits service revenue in fiscal 2002 compared with the prior year are primarily related to increases in clients for Retirement Services and increases in Paychex Administrative Services (PAS) and Professional Employer Organization (PEO) client employees serviced. The increase in Retirement Services clients reflects the continuing interest of small- to medium-sized businesses in offering retirement savings benefits to their employees. Retirement Services revenues increased 33% and 30% in the third quarter and nine-month periods to $15.3 million and $41.3 million, respectively. At February 28, 2002, the Company serviced over 22,000 Retirement Services clients.

The Paychex Administrative Services (PAS) product is a combined package of payroll, employer compliance, employee benefit administration and risk management outsourcing services designed to make it easier for small businesses to manage their payroll and benefit costs. This product was introduced in May 2000 and was available nationwide by the end of fiscal 2001. The Company's PEO product provides the same bundled services as the PAS product, but as a co-employer of the client's employees. The PEO service is available primarily in the states of Florida and Georgia, where PEOs are popular and operate under a favorable regulatory environment. Sales of the PAS and PEO products have been strong, with administrative fee revenue from these products increasing 38% and 43% in the third quarter and nine-month periods of fiscal 2002 compared with the respective prior year periods. As of February 28, 2002, the PAS and PEO products serviced over 72,000 client employees.

The decreases in interest on funds held for clients are primarily the result of lower interest rates in fiscal 2002 offset somewhat by higher average daily portfolio balances. For the quarter, net realized gains on available-for-sale securities included in interest on funds held for clients decreased to $2.3 million compared with $3.4 million in the prior year third quarter. For the first nine months of fiscal 2002, net realized gains increased to $7.6 million compared with $3.1 million in the respective prior year period. The funds held for clients portfolio earned an average rate of return of 2.6% and 3.1% in the third quarter and first nine months of fiscal 2002 compared with 4.9% in both the respective prior year periods. The average daily portfolio balances totaled approximately $1.90 billion and $1.75 billion for the quarter and nine months ended February 28, 2002 compared with $1.80 billion and $1.55 billion in the respective fiscal 2001 periods. The increase reflects higher utilization of Taxpay and Employee Pay Services by new and existing clients.

The combined increases in operating and SG&A expenses reflect increases in personnel, information technology and facility costs necessary to support the growth of the Company. At February 28, 2002, the Company had approximately 7,300 employees compared with approximately 7,100 at February 28, 2001. To enhance overall customer service, in fiscal 2001 the Company implemented an initiative to decrease the number of clients serviced per payroll specialist and increased salaries of payroll specialists in an effort to improve retention. Also, during fiscal 2001, the Company increased the number of personnel servicing the Company's PAS product. These initiatives were implemented throughout fiscal 2001, and the impact of the higher expenses on year-over-year growth rates is lower in the second half of fiscal 2002.

Investment income represents earnings from the Company's cash and cash equivalents and investments in available-for-sale securities. Investment income does not include interest on funds held for clients, which is included in total revenues. The increases in investment income are primarily due to net realized gains on the sale of available-for-sale securities and the increase in average daily invested balances, offset by lower interest rates in fiscal 2002. Net realized gains included in investment income were $2.4 million and $5.2 million for the third quarter and nine months of fiscal 2002 compared with $.6 million and $.4 million in the respective prior year periods. Average daily balances invested were approximately $.70 billion and $.65 billion for the third quarter and nine months ended February 28, 2002 compared with $.60 billion and $.55 billion in the respective prior year periods. The increases in the average portfolio balances were driven by additional net cash inflows from operations. The Corporate investment portfolio earned an average rate of return of 3.6% and 3.9% in the third quarter and first nine months of fiscal 2002 compared with 4.7% and 4.6% in the respective prior year periods.

The effective income tax rate was 30.0% and 30.5% in the third quarter and nine-month periods of fiscal 2002 compared with 29.5% and 30.1% in the respective prior year periods. The full year fiscal 2002's effective income tax rate is expected to approximate 30.5%.

Economic Conditions and Outlook:

The Company first experienced the effects of the recession in the first quarter of fiscal 2002, and these effects have continued during the second and third quarters. In response to the declining economic conditions, the Federal Reserve has lowered the Federal Funds rate eleven times since January 2001 to 1.75%, which represents a cumulative 475 basis point reduction. The last reduction in the Federal Funds rate occurred in December 2001. The impact of the rate cuts on year-over-year comparisons for interest on funds held for clients and corporate investment income was more significant in the third quarter and that trend is expected to continue in the fourth quarter of this fiscal year. Year-over-year comparisons for these income sources combined were up 14% and 2% for the first and second quarters of fiscal 2002, respectively, but were down 30% for the third quarter and are expected to be down approximately 30% to 35% for the fourth quarter of fiscal 2002. The difficult year-over-year comparisons for interest on funds held for clients and corporate investment income is expected to continue into, and possibly throughout, fiscal 2003.

The decrease in interest rates has resulted in an increase in the market value of the Company's available-for-sale portfolios. The combined funds held for clients and corporate available-for-sale investment portfolios reflected unrealized gains of $32.1 million at February 28, 2002 and $20.5 million at May 31, 2001 compared with unrealized losses of $13.4 million at May 31, 2000. The unrealized gain position of the Company's investment portfolios was approximately $17 million at March 14, 2002. Refer to the "Market Risk Factors" section of this review for further discussion of interest rates and related risks.

In addition to the effects of volatile interest rates, the impact of a recessionary economy has resulted in a lower number of checks per client as existing clients reduce their work forces. During the third quarter of fiscal 2002, the Company experienced a 4.8% decline in checks per client compared to 4.3% in the second quarter and 2.6% in the first quarter. For the first nine months of fiscal 2002, checks per client declined 3.9%. During the recession of the early 1990's, the Company experienced total reduction in checks per client of approximately 3%.

Despite the above factors, income before taxes remained strong at 42% of total revenues during the first nine months of fiscal 2002, which is consistent with the same period last year. The Company estimates that if the interest rates and checks per client conditions experienced in fiscal 2000 had continued throughout fiscal 2001 and the first nine months of fiscal 2002, net income growth for fiscal 2001 would have been approximately 25% compared with actual growth of 34%, and net income growth for the first nine months of fiscal 2002 would have been approximately 20% compared with actual growth of 10%. The average interest rate (exclusive of net realized gains and losses) earned in fiscal 2000 for the Company's combined investment portfolios was approximately 4.4% compared with 4.6% in fiscal 2001 and 3.3% for the first nine months of fiscal 2002.

The U.S. economic conditions and interest rate trends represent uncertainties which are expected to continue to affect total revenue growth. For fiscal 2002, the Company projects Payroll service revenue growth in the range of 11% to 12% and Human Resource and Benefits service revenue growth in the range of 22% to 24%. Total service revenue growth is anticipated to be in the range of 12% to 14%.

Taking the aforementioned factors into consideration and assuming no further deterioration to interest rates or current economic conditions, total revenue growth for fiscal 2002 is anticipated to be in the range of 9% to 10%, with net income growth slightly less than total revenue growth.

LIQUIDITY AND CAPITAL RESOURCES

Operating activities

(In thousands) For the nine months ended February 28,	2002	Change	2001	Change
Operating cash flows	$277,348	8.2%	$256,239	32.8%

The increase in operating cash flows for the first nine months of fiscal 2002 reflects achievement of higher net income. Projected operating cash flows are expected to adequately support normal business operations, purchases of property and equipment and dividend payments. At February 28, 2002, the Company had $760.1 million in available cash and corporate investments. The Company has two available, uncommitted, unsecured lines of credit from various banks totaling $140 million at market rates of interest. The Company also has an available, uncommitted, secured line of credit from a bank totaling $350 million at market rates of interest. No amounts were outstanding against these lines of credit at February 28, 2002 or May 31, 2001.

Investing activities

(In thousands) For the nine months ended February 28,	2002	Change	2001	Change
Net funds held for clients and corporate investment activities	$(27,241)	-67.1%	$ (82,899)	-16.7%
Purchases of property and equipment	(32,708)	12.9%	(28,971)	12.8%
Proceeds from the sale of property and equipment	10	-75.6%	41	-96.8%
Purchases of other assets	(1,268)	-81.3%	(6,773)	5.6%
Net cash used in investing activities	$(61,207)	-48.4%	$(118,602)	-9.0%

Funds held for clients and corporate investments: Funds held for clients are primarily comprised of short-term funds and available-for-sale debt securities, and corporate investments are primarily comprised of available-for-sale debt securities. The portfolio of funds held for clients and corporate investments is detailed in Note D of the Notes to the Consolidated Financial Statements.

The reported amount of funds held for clients will vary significantly based upon the timing of collecting client funds, and the related remittance of funds to the applicable tax authorities for Taxpay clients and employees of clients utilizing Employee Pay Services. Corporate investments have increased due to the investment of growing cash balances provided by operating activities less purchases of property and equipment and dividend payments. Additional discussion of interest rates and related risks is included in the "Market Risk Factors" section of this review.

Purchases of property and equipment: To support the Company's continued client and ancillary product growth, purchases of property and equipment were made for data processing equipment and software, and for the expansion and upgrade of various operating facilities.

Purchases of property and equipment in fiscal 2002 are expected to be in the range of $50 million to $55 million including additional expenditures anticipated for a new data center in Rochester, New York. Fiscal 2002 depreciation expense is projected to be in the range of $28 million to $30 million.

Financing activities

(In thousands, except per share amounts) For the nine months ended February 28,	2002	Change	2001	Change
Dividends paid	$(116,141)	29.8%	$(89,457)	50.9%
Proceeds from exercise of stock options	13,811	20.3%	11,480	28.7%
Net cash used in financing activities	$(102,330)	31.2%	$(77,977)	54.8%
Cash dividends per common share	$ .31	29.2%	$ .24	50.0%

Dividends paid: In October 2001, the Board of Directors approved a 22.2% increase in the quarterly dividend payment to $.11 per share from $.09 per share. During the quarter ended February 28, 2002, the Company's Board of Directors declared a dividend in the amount of $.11 per share, which was paid February 15, 2002 to shareholders of record as of February 1, 2002. Future dividends are dependent on the Company's future earnings and cash flow.

Proceeds from exercise of stock options: The increase in proceeds from the exercise of stock options is primarily due to an increase in the comparable average exercise prices per share. Shares exercised in the nine months of fiscal 2002 were slightly lower at 1,455,000 shares compared with 1,554,000 in the prior year period. The Company has recognized a tax benefit from the exercise of stock options of $15.5 million and $23.1 million for the nine months ended February 28, 2002 and 2001, respectively. This tax benefit reduces the accrued income tax liability and increases additional paid-in capital, with no impact on the expense amount for income taxes.

MARKET RISK FACTORS

Interest Rate Risk: Funds held for clients are primarily comprised of short-term funds and available-for-sale debt securities, and corporate investments are primarily comprised of available-for-sale debt securities. The Company's available-for-sale debt securities are exposed to interest rate risk as interest rate volatility will cause fluctuations in the market value of held investments and the earnings potential of future investments. Decreases in interest rates normally increase the market value of the available-for-sale securities, while increases in interest rates decrease the market value of the available-for-sale securities. The Company's available-for-sale securities and short-term funds are exposed to earnings risk from changes in interest rates, as rate volatility will cause fluctuations in the earnings potential of future investments. Decreases in interest rates quickly decrease earnings from short-term funds, and over time decrease earnings from the available-for-sale securities portfolio. Increases in interest rates have the opposite earnings effect on the available-for-sale securities and short-term funds. Earnings from the available-for-sale securities do not reflect changes in rates until the investments are sold or mature, and the proceeds are reinvested at current rates. The immediate impact of changing interest rates on earnings from short-term funds may be temporarily offset by realized gains or losses from transactions in the Company's available-for-sale portfolio. The Company estimates that the earnings effect of a 25-basis-point change in interest rates (17 basis points for tax-exempt investments) at this point in time would be approximately $3.0 million for the next twelve-month period.

The Company directs investments towards high credit-quality, tax-exempt securities to mitigate the risk that earnings from the portfolio could be adversely impacted by changes in interest rates in the near term. The Company invests in short- to intermediate-term, fixed-rate municipal and government securities, which typically have lower interest rate volatility, and manages the securities portfolio to a benchmark duration of 2.5 to 3.0 years. The Company does not utilize derivative financial instruments to manage interest rate risk.

The recent trend in interest rates has been toward interest rate reductions. The following table summarizes recent changes in the Federal Funds rate:

	Fiscal Year 2002 Year-to-date	Fiscal Year Ended May 31, 2001	Fiscal Year Ended May 31, 2000
Federal Funds rate – beginning of period	4.00%	6.50%	4.75%
Rate increase/(decrease):			
First quarter	(.50)	—	.50
Second quarter	(1.50)	—	.25
Third quarter	(.25)	(1.00)	.25
Fourth quarter	N/A	(1.50)	.75
Federal Funds rate – end of period	1.75%	4.00%	6.50%
Three-Year “AAA” Municipal Securities Yield — end of period	2.72%	3.44%	4.96%

Calculating the future effects of changing interest rates involves many factors. These factors include, but are not limited to, daily interest rate changes, seasonal variations in investment balances, actual duration of short- and intermediate-term investments, the proportional mix of taxable and tax-exempt investments, and changes in tax-exempt municipal rates versus taxable investment rates, which are not synchronized or simultaneous. Subject to these factors, a 25-basis-point change generally affects the Company’s tax-exempt interest rates by approximately 17 basis points. Realized gains are more prevalent in a decreasing rate environment and realized losses are more prevalent in an increasing rate environment. During the first nine months of fiscal 2002, the Company’s total investment portfolio averaged approximately $2.4 billion and is expected to average $2.5 billion for the full year fiscal 2002. The Company’s normal and anticipated allocation is approximately 50% invested in short-term securities with a duration of less than thirty days and 50% invested in intermediate-term municipal securities with an average duration of three years.

The decrease in interest rates has resulted in an increase in the market value of the Company’s available-for-sale portfolios. The combined funds held for clients and corporate available-for-sale investment portfolios reflected unrealized gains of $32.1 million at February 28, 2002 and $20.5 million at May 31, 2001 compared with unrealized losses of $13.4 million at May 31, 2000. The unrealized gain position of the Company’s investment portfolios was approximately $17 million at March 14, 2002. As of February 28, 2002 and May 31, 2001, the Company had $1.4 billion and $1.3 billion, respectively, invested in available-for-sale securities at fair value, with weighted average yields to maturity of 3.9% and 4.3%, respectively. Assuming a hypothetical decrease in both short-term and intermediate-term interest rates of 25 basis points, the resulting potential increase in fair value for the portfolio of securities at February 28, 2002 would be in the range of $8.0 million to $8.5 million. Conversely, a corresponding increase in interest rates would result in a comparable decrease in fair value. This hypothetical decrease or increase in the fair value of the portfolio would be recorded as an adjustment to the portfolio's recorded value, with an offsetting amount recorded in stockholders' equity, and with no related or immediate impact to the results of operations.

Credit Risk: The Company is exposed to credit risk in connection with these investments through the possible inability of the borrowers to meet the terms of the bonds. The Company attempts to limit credit risk by investing primarily in AAA and AA rated securities and A-1 rated short-term securities, and by limiting amounts that can be invested in any single instrument. At February 28, 2002, approximately 98% of the available-for-sale securities held an AA rating or better, and all short-term securities classified as cash equivalents held an A-1 or equivalent rating.

OTHER

Stock Volatility: The market price of the Company's common stock could be influenced by factors such as quarterly variations in operating results, announcements of new services or technological innovations by the Company or its competitors, market conditions in the business process outsourcing industry, changes in ratings or financial estimates by securities analysts, economic conditions, price and fluctuations in the stock market that are not directly related to the Company's operating performance, and other factors and events which are beyond the Company's control. These and other factors can lead to fluctuations in the Company's quoted stock price.

New Accounting Pronouncements: In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard 141, "Business Combinations" (SFAS No. 141) and Statement of Financial Accounting Standard 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 141 requires that all future business combinations be accounted for using the purchase method of accounting and the use of the pooling-of-interest method is prohibited for transactions initiated after July 1, 2001. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets. This statement recognizes that goodwill has an indefinite useful life and will no longer be subject to periodic amortization, but rather periodically evaluated for impairment. The statement also requires an evaluation of existing acquired goodwill and other intangible assets for proper classification under the new requirements. The Company adopted these standards in the first quarter of fiscal 2002. Adoption of these standards did not have a material impact on the results of operations or financial position of the Company.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires companies to record a liability at fair value for asset retirement obligations in the period in which they are incurred. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This Statement is effective for the Company for the fiscal year beginning June 1, 2003. The Company is currently evaluating the provisions of this Statement but does not believe adoption of this Statement will result in a material impact to its results of operations or financial position.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which provides a single accounting model for long-lived assets to be disposed of. This Statement is effective for the Company for the fiscal year beginning June 1, 2002. The Company is currently evaluating the provisions of this statement but does not anticipate that adoption will result in a material impact to its results of operations or financial position.

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995: Certain written and oral statements made by Paychex, Inc. (the "Company") management may constitute "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are identified by such words and phrases as "we expect," "expected to," "estimates," "we look forward to," "would equate to," "projects," "projected to be," "anticipates," "we believe," "could be," and other similar phrases. Because they are forward-looking, they should be evaluated in light of important risk factors. These risk factors include, but are not limited to, general market and economic conditions, including demand for the Company's products and services, availability of internal and external resources, executing expansion plans, competition, and price levels; changes in the laws regulating collection and payment of payroll taxes, professional employer organizations, and employee benefits, including 401(k) plans, workers' compensation, state unemployment, and section 125 plans; delays in the development, timing of the introduction, and marketing of new products and services; changes in technology, including use of the Internet; the possibility of catastrophic events that could impact the Company's operating facilities, computer systems, communication systems, and business reputation; stock volatility; and changes in short- and long-term interest rates, changes in the market value of available-for-sale securities, and the credit rating of cash, cash equivalents, and securities held in the Company's investment portfolios, all of which could cause actual results to differ materially from anticipated results. The information provided in this document is based upon the facts and circumstances known at this time. The Company assumes no obligation to update this document for new information subsequent to its issuance.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK

The information called for by this item is provided under the caption "Market Risk Factors" under ITEM 2 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

PART II. OTHER INFORMATION

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits: Exhibit 3(ii): By-Laws of Paychex, Inc., as amended

(b) Reports on Form 8-K:

(1) The Company filed a report on Form 8-K on December 19, 2001 that included the Company's press release dated December 19, 2001 reporting the Company's results of operations for the second quarter and six-month periods of fiscal 2002.

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.

Date: March 19, 2002

/s/ B. Thomas Golisano
B. Thomas Golisano
Chairman, President and
Chief Executive Officer

Date: March 19, 2002

/s/ John M. Morphy
John M. Morphy
Vice President, Chief
Financial Officer and Secretary

EXHIBIT 3 (II)

BY-LAWS

OF

PAYCHEX, INC.

ARTICLE I

OFFICES

SECTION 1. The registered office of Paychex, Inc., a Delaware corporation (hereinafter referred to as the "Corporation"), shall be located within the State of Delaware.

SECTION 2. The Corporation may also have offices at such places, either within or without the State of Delaware and either within or without the United States of America, as the board of directors may from time to time designate or the business of the Corporation may require.

ARTICLE II

MEETINGS OF STOCKHOLDERS

SECTION 1. All meetings of the stockholders for the election of directors or for any other purpose shall be held at such time and place, either within or without the State of Delaware and either within or without the United States of America, as shall be stated in the notice of meeting or in a duly executed waiver thereof.

SECTION 2. The annual meeting of stockholders shall be held on such date and at such hour as shall be designated each year by the board of directors. At such annual meeting, the stockholders shall elect a board of directors and transact such other business as may be properly brought before the meeting.

SECTION 3. Special meetings of stockholders for any purpose or purposes, unless otherwise prescribed by statute or by the Corporation's certificate of incorporation, may be called by the Chairman of the Board or the President and shall be called by the Chairman of the Board, the President or the Secretary at the request in writing of a majority of the board of directors, or at the request in writing of stockholders owning a majority in amount of the entire capital stock of the Corporation issued and outstanding and entitled to vote. Such request shall state the purpose or purposes of the proposed meeting.

SECTION 4. Except as otherwise expressly required by statute, written notice of each annual and special meeting of stockholders, stating the place, date and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be given to each stockholder of record entitled to vote thereat not less than ten (10) nor more than sixty (60) days before the date of the meeting. Notice shall be given personally or by mail and, if by mail, shall be sent in a postage prepaid envelope, addressed to the stockholder at his address as it appears on the records of the Corporation. Notice by mail shall be deemed given at the time when the same shall be deposited in the United States mail, postage prepaid. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when such person attends the meeting in person or by proxy for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. A written waiver of notice signed by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Neither the business to be transacted at, nor the purpose of, an annual or special meeting of stockholders need be specified in any written waiver of notice. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

SECTION 5. The officer who has charge of the stock transfer books of the Corporation shall prepare and make, at the time and in the manner required by applicable law, a list of stockholders entitled to vote and shall make such list available for such purposes, at such places, at such times and to such persons as required by applicable law. The stock transfer books shall be the only evidence as to the identity of the stockholders entitled to examine the stock transfer books or to vote in person or by proxy at any meeting of stockholders.

SECTION 6. The holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum for the transaction of business at any meeting of stockholders, except as otherwise provided by statute or by the Corporation's certificate of incorporation. The stockholders present and entitled to vote at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders entitled to vote to leave less than a quorum then present and represented provided that the action taken (other than an adjournment) is approved by at least a majority of the holders of stock required to constitute a quorum. Any stockholders' meeting, annual or special, whether or not a quorum is present or represented, may be adjourned from time to time by the vote of the holders of a majority of the stock entitled to vote thereat, the holders of which are either present in person or represented by proxy, or the chairman of the meeting, but in the absence of a quorum no other business may be transacted at such meeting. At any adjourned meeting, at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified, except for such business as was duly transacted at any earlier meeting. If the adjournment is for more than thirty (30) days, or if after adjournment a new record date is set, a notice of the adjourned meeting shall be given as in the case of an original meeting to each stockholder of record entitled to vote at the meeting.

SECTION 7. At each meeting of stockholders, the Chairman of the Board or, in his absence or inability to act, such other person as the board of directors may have designated shall call to order and act as chairman of the meeting. The Secretary or, in his absence or inability to

act, the person whom the chairman of the meeting shall appoint secretary of the meeting shall act as secretary of the meeting and keep the minutes thereof.

SECTION 8. The order of business and the procedure at all meetings of the stockholders shall be as determined by the chairman of the meeting, unless otherwise prescribed by law or regulation.

SECTION 9. Except as otherwise provided by statute or the Corporation's certificate of incorporation, each holder of common stock of the Corporation shall be entitled at each meeting of stockholders to one (1) vote for each share of such stock standing in his name on the record of stockholders of the Corporation

(a) on the date fixed pursuant to the provisions of Section 7 of Article V of these by-laws as the record date for the determination of the stockholders who shall be entitled to notice of and to vote at such meeting; or

(b) if no such record date shall have been so fixed, then at the close of business on the day next preceding the day on which notice thereof shall be given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held.

Each stockholder entitled to vote at any meeting of stockholders may authorize another person or persons to act for him by a proxy signed by such stockholder or his attorney-in-fact, but no proxy shall be voted after three (3) years from its date, unless the proxy provides for a longer period. Any such proxy shall be delivered to the secretary of the meeting at or prior to the time designated in the order of business for so delivering such proxies. When a quorum is present at any meeting, the vote of the holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereon, present in person or represented by proxy, shall decide any question brought before such meeting, unless the question is one upon which, by express provision of statute or of the Corporation's certificate of incorporation or of these by-laws, a different vote is required, in which case such express provision shall govern and control the decision of such question. On a vote by ballot, each ballot shall be signed by the stockholder voting, or by his proxy, if represented by proxy, and shall state the number of shares voted.

SECTION 10. The board of directors may, in advance of any meeting of stockholders, appoint one or more inspectors to act at, and make a written report of, such meeting or any adjournment thereof. If any of the inspectors so appointed shall fail to appear or act, the chairman of the meeting shall, or, if inspectors shall not have been appointed, the chairman of the meeting may, appoint one or more inspectors. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability. The inspectors shall determine the number of shares of capital stock of the Corporation outstanding and the voting power thereof, the number of shares represented at the meeting, the existence of a quorum and the authenticity, validity and effect of proxies, certify their determination of the number of shares represented at the meeting and shall receive votes or ballots, hear, determine and retain for a reasonable period a record of the disposition of, all challenges and questions arising in

connection with the right to vote, count and tabulate all votes or ballots, determine the results and perform such acts as are proper to conduct the election or vote with fairness to all stockholders. If more than one inspector has been appointed, the decision, act or certificate of a majority of the inspectors is effective in all respects as the decision, act or certificate of all of the inspectors. On request of the chairman of the meeting, the inspector shall make a report in writing of any challenge, request or matter determined by them and shall execute a certificate of any fact found by them. No director or candidate for the office of director shall act as an inspector of election with respect to an election of directors. Inspectors need not be stockholders.

SECTION 11. Any action required or permitted to be taken at any annual or special meeting of the stockholders may be taken without a meeting, without prior notice and a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted and shall be delivered to the Corporation by delivery to its registered office in Delaware, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested. Where corporate action is taken in such manner by less than unanimous written consent, prompt written notice of the taking of such action shall be given to all stockholders who have not consented in writing thereto.

Every written consent shall bear the date of signature of each stockholder who signs the consent and no written consent shall be effective to take the corporate action referred to therein unless, within sixty days of the earliest dated consent delivered in the manner required by statute to the Corporation, written consents signed by a sufficient number of holders to take action are delivered to the Corporation by delivery to its registered office in Delaware, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested.

ARTICLE III

BOARD OF DIRECTORS

SECTION 1. The number of directors which shall constitute the whole board of directors shall consist of one or more members, the exact number to be fixed from time to time by the board of directors. Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal.

SECTION 2. The business and affairs of the Corporation shall be managed by or under the direction of the board of directors. The board of directors may exercise all such authority and powers of the Corporation and do all such lawful acts and things as are not by statute, the

Corporation's certificate of incorporation or these by-laws directed or required to be exercised or done by the stockholders.

SECTION 3. Meetings of the board of directors shall be held at such place or places, within or without the State of Delaware and either within or without the United States of America, as the board of directors may from time to time determine or as shall be specified in the notice of any such meeting.

SECTION 4. The board of directors shall meet for the purpose of organization, the election of officers and the transaction of other business, as soon as practicable after each annual meeting of stockholders. Notice of such meeting need not be given. In the event such annual meeting is not so held, the annual meeting of the board of directors may be held at such other time, within or without the State of Delaware and either within or without the United States of America, as shall be specified in a notice thereof given as provided in

Section 7 of this Article III.

SECTION 5. Regular meetings of the board of directors shall be held at such time and place as the board of directors may fix. If any day fixed for a regular meeting shall be a legal holiday at the place where the meeting is to be held, then the meeting which would otherwise be held on that day shall be held at the same hour on the next succeeding business day. Notice of regular meetings of the board of directors need not be given.

SECTION 6. Special meetings of the board of directors may be called by the Chairman of the Board or the President and shall be called by the Secretary on the written request of a majority of the members of the Board of Directors.

SECTION 7. Notice of each special meeting of the board of directors shall be given by the President or the Secretary as hereinafter provided in this Section 7, in which notice shall be stated the time and place of the meeting. Except as otherwise required by these by-laws, such notice need not state the purpose or purposes of such meeting. Notice of each such meeting shall be mailed, postage prepaid, to each director, addressed to him at his residence or usual place of business, by first class mail, at least two (2) days before the time of the meeting, or shall be sent addressed to him at such place by telegraph, cable, telex, telefax, telecopier or other similar means, or be delivered to him personally or be given to him by telephone or other similar means, at least twelve (12) hours before the time of the meeting. A written waiver of notice signed by a director, whether before or after the time stated therein, shall be deemed equivalent to notice to such director. Attendance of a director at the meeting shall constitute a waiver of notice of such meeting by such director, except when such director attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

SECTION 8. At all meetings of the board of directors, a majority of the total number of directors shall be necessary and sufficient to constitute a quorum for the transaction of business and, except as otherwise expressly required by statute or the Corporation's certificate of incorporation or these by-laws, the act of a majority of the directors present at any meeting at which a quorum is present shall be the act of the board of directors. In the absence of a quorum at any meeting of the board of directors, a majority of the directors present thereat may adjourn

such meeting to another time and place. Notice of the time and place of any such adjourned meeting shall be given to all of the directors unless such time and place were announced at the meeting at which the adjournment was taken, in which case such notice shall only be given to the directors who were not present thereat. At any adjourned meeting at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally called. The directors shall act only as a board and the individual directors shall have no power as such.

SECTION 9. Any director of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its tender. Unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective. Any vacancy in the board of directors caused by such resignation may be filled by a majority vote of the board of directors for the unexpired portion of the term.

SECTION 10. Any director of the Corporation may be removed, at any time, with or without cause, by the affirmative vote of the holders of record of a majority of the outstanding shares of stock entitled to vote at a meeting of stockholders, and any vacancy in the board of directors caused by any such removal may be filled by the stockholders at said meeting in which the vacancy is created or, if not so filled, by a majority vote of the Board of Directors for the unexpired portion of the term.

SECTION 11. Unless restricted by the Corporation's certificate of incorporation, the board of directors may, by resolution passed by a majority of the entire board of directors, designate one or more committees, including an executive committee, each committee to consist of one or more of the directors of the Corporation. The board of directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, a member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place or any such absent or disqualified member. Except to the extent restricted by statute or the Corporation's certificate of incorporation, each such committee, to the extent provided in the resolution creating it, shall have and may exercise all of the powers and authority of the board of directors, including, if such resolution so provides, the power to declare a dividend, to authorize the issuance of stock or to adopt a certificate of ownership and merger pursuant to section 253 of Title 8 of the Delaware Code, and may authorize the seal of the Corporation to be affixed to all papers which require it. Each such committee shall serve at the pleasure of the board of directors and have such name as may be determined from time to time by resolution adopted by the board of directors. Each committee shall keep regular minutes of its meetings and report the same to the board of directors.

SECTION 12. Any action required or permitted to be taken by the board of directors or any committee thereof may be taken without a meeting if all members of the board of directors or such committee, as the case may be, consent thereto in writing, and the writing or writings are

filed with the minutes of the proceedings of the board of directors or such committee, as the case may be.

SECTION 13. Any one or more members of the board of directors or any committee of the board of directors may participate in a meeting of the board of directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other. Participation by such means shall constitute presence in person at a meeting.

SECTION 14. A director of the Corporation who is present at a meeting of the board of directors or any committee thereof at which action is taken shall be presumed to have assented to the action taken unless his dissent or abstention therefrom shall be entered in the minutes of the meeting or unless he shall file a written dissent from such action with the person acting as the secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the Secretary of the Corporation within five days after the date a copy of the minutes of the meeting is received. Such right to dissent shall not apply to a director who voted in favor of such action.

SECTION 15. The Board of Directors shall have the authority to fix the compensation of directors for services in any capacity.

ARTICLE IV

OFFICERS

SECTION 1. The officers of the Corporation shall be elected annually by the board of directors at the first meeting of the board held after each annual meeting of stockholders, or as soon thereafter as possible. The board of directors shall elect from among its number a Chairman of the Board. The board of directors shall also elect a President, a Secretary and a Treasurer, who need not be directors. If the board of directors wishes, it may also elect such other officers (including, without limitation, one or more Vice Presidents, one or more Assistant Treasurers and one or more Assistant Secretaries) as may be necessary or desirable for the business of the Corporation. Any two or more offices may be held by the same person. Each officer shall hold office until his successor shall have been duly elected and qualified, or until his death, resignation or removal, as hereinafter provided. A vacancy in any office because of death, resignation, removal, disqualification or otherwise, shall be filled only by a majority vote of the board of directors for the unexpired portion of the term.

SECTION 2. Any officer of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its tender. Unless otherwise specified therein, the acceptance of any such registration shall not be necessary to make it effective.

SECTION 3. Any officer of the Corporation may be removed, either with or without cause, at any time, by the board of directors at any meeting thereof, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

SECTION. 4. The Chairman of the Board of Directors, if there be one, shall preside at all meetings of the stockholders and of the Board of Directors. He shall be the Chief Executive Officer of the Corporation, and except where by law the signature of the President is required, the Chairman of the Board of Directors shall possess the same power as the President to sign all contracts, certificates and other instruments of the Corporation which may be authorized by the Board of Directors. During the absence or disability of the President, the Chairman of the Board of Directors shall exercise all the powers and discharge all the duties of the President. The Chairman of the Board of Directors shall also perform such other duties and may exercise such other powers as from time to time may be assigned to him by these By-Laws or by the Board of Directors.

SECTION 5. The President shall, subject to the control of the Board of Directors and, if there be one, the Chairman of the Board of Directors, have general supervision of the business of the Corporation and shall see that all orders and resolutions of the Board of Directors are carried into effect. He shall execute all bonds, mortgages, contracts and other instruments of the Corporation requiring a seal, under the seal of the Corporation, except where required or permitted by law to be otherwise signed and executed and except that the other officers of the Corporation may sign and execute documents when so authorized by these By-Laws, the Board of Directors or the President. In the absence or disability of the Chairman of the Board of Directors, or if there be none, the President shall preside at all meeting of the stockholders and the Board of Directors, the President shall be the chief executive and operating officer of the Corporation. He shall perform all duties incident to the office of chief executive and operating officer and such other duties as may from time to time be assigned to him by the Board of directors.

SECTION 6. Each Vice President, if any, shall perform all duties incident to his office and such other duties as from time to time may be assigned to him by the board of directors, the Chairman of the Board or the President.

SECTION 7. The Treasurer shall

(a) be the principal financial officer and principal accounting officer of the Corporation;

(b) have charge and custody of, and be responsible for, all the funds and securities of the Corporation;

(c) keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation;

(d) deposit all moneys and other valuables to the credit of the Corporation in such depositories as may be designated by the board of directors or pursuant to its direction;

(e) receive, and give receipts for, moneys due and payable to the Corporation from any source whatsoever;

(f) disburse the funds of the Corporation and supervise the investment of its funds, taking proper vouchers therefor;

(g) render to the board of directors, whenever the board of directors may require, an accounting of the financial condition of the Corporation; and

(h) in general, perform all other duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the board of directors or the President.

SECTION 8. Secretary. The Secretary shall

(a) keep or cause to be kept, in one or more books provided for the purpose, the minutes of all meetings of the board of directors, the committees of the board of directors and the stockholders;

(b) see that all notices are duly given in accordance with the provisions of these by-laws and as required by law;

(c) see that the books, reports, statements certificates and other documents and records required by law to be kept and filed are properly kept and filed; and

(d) in general, perform all other duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the board of directors or the President.

SECTION 9. The Assistant Treasurer, if any, or if there shall be more than one, the Assistant Treasurers in the order determined by the board of directors (or, if there be no such determination, then in the order of their election), shall, at the request of the President or the Treasurer or in the absence of the Treasurer or in the event of his inability or refusal to act, perform the duties of the Treasurer (and when so acting, shall have the powers of and be subject to the restrictions placed upon the Treasurer in respect of the performance of such duties) and shall perform such other duties as from time to time may be assigned by the board of directors or the President.

SECTION 10. The Assistant Secretary, if any, or if there be more than one, the Assistant Secretaries in the order determined by the board of directors (of, if there be no such determination, then in the order of their election), shall, at the request of the President or the Secretary or in the absence of the Secretary or in the event of his inability or refusal to act, perform the duties of the Secretary (and when so acting, shall have the powers of and be subject to the restrictions placed upon the Secretary in respect of the performance of such duties) and shall perform such other duties as from time to time may be assigned by the board of directors or the President.

SECTION 11. If required by the board of directors, any officer of the Corporation shall give a bond or other security for the faithful performance of his duties, in such amount and with such surety as the board of directors may require.

SECTION 12. The compensation of the officers of the Corporation for their services as such officers shall be fixed from time to time by the board of directors. An officer of the Corporation shall not be prevented from receiving compensation by reason of the fact that he is also a director of the Corporation.

ARTICLE V

STOCK CERTIFICATES AND THEIR TRANSFER

SECTION 1. Every holder of stock in the Corporation shall be entitled to have a certificate signed by, or in the name of the Corporation by the Chairman of the Board, the President or a Vice President and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary of the Corporation certifying the number of shares owned by him in the Corporation. If the Corporation shall be authorized to issue more than one class of stock or more than one series of any class, the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preference and/or rights shall be set forth in full or summarized on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in Section 202 of the General Corporation Law of the State of Delaware, in lieu of the foregoing requirements, there may be set forth, on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, a statement that the Corporation will furnish without charge to each stockholder who so requests the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

SECTION 2. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issuance.

SECTION 3. The board of directors may direct that a new certificate or certificates be issued in place of any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen or destroyed. When authorizing the issuance of a new certificate or certificates, the board of directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate or certificates, or his legal representative, to give the Corporation a bond or other indemnity in such amount as it may direct sufficient to indemnify it against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

SECTION 4. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon

its records; provided, however, that the Corporation shall be entitled to recognize and enforce any lawful restriction on transfer. Whenever any transfer of stock shall be made for collateral security, and not absolutely, it shall be so expressed in the entry of transfer if, when the certificates are presented to the Corporation for transfer, both the transferor and the transferee request the Corporation to do so. Persons whose stock is pledged shall be entitled to vote, unless in the transfer by the pledgor on the books of the Corporation he has expressly empowered the pledgee to vote thereon, in which case only the pledgee, or his proxy, may represent and vote such stock.

SECTION 5. The board of directors may appoint, or authorize any officer or officers to appoint, one or more transfer agents and one or more registrars.

SECTION 6. The board of directors may make such additional rules and regulations, not inconsistent with these by-laws, as it may deem expedient concerning the issuance, transfer and registration of certificates for shares of stock of the Corporation.

SECTION 7. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or any allotment of rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors fix a new record date for the adjourned meeting.

SECTION 8. The Corporation shall be entitled to recognize the exclusive right of a person registered on its records as the owner of shares of stock to receive dividends and to vote as such owner, shall be entitled to hold liable for calls and assessments a person registered on its records as the owner of shares of stock, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares of stock on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE VI

INDEMNIFICATION

SECTION 1. To the full extent authorized by law, the Corporation shall indemnify any person made, or threatened to be made, a party in any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director or officer of the Corporation, or is serving or served any other corporation, or any partnership, joint venture, trust, employee benefit plan or other enterprise, in any such capacity at the request of the Corporation ("indemnitee") against expenses (including

attorneys' and other fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection therewith.

SECTION 2. Expenses actually and reasonably incurred by an indemnitee in defending a civil or criminal action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon an undertaking by or on behalf of such indemnitee to repay such amount if it shall ultimately be determined, by final judicial decision from which there is no further right of appeal, that he is not entitled to be indemnified by the Corporation. To be entitled to such advancement of expenses, the indemnitee shall cooperate in good faith with any request by the Corporation that common counsel be used by parties to such action or proceeding who are similarly situated unless it would be inappropriate to do so because of actual or potential conflicts between the interests of such parties.

SECTION 3. The Corporation may, to the extent authorized by the board of directors, grant rights of indemnification and advancement of expenses to any employee or agent of the Corporation to the full extent of the provisions of this Article with respect to indemnification and advancement of expenses of directors and officers of the Corporation.

SECTION 4. The indemnification provided by this Article shall not be deemed exclusive of any other rights to which any person covered hereby may be entitled other than pursuant to this Article.

ARTICLE VII

GENERAL PROVISIONS

SECTION 1. Subject to the provisions of law and the Corporation's certificate of incorporation, dividends upon the shares of capital stock of the Corporation may be declared by the board of directors at any regular or special meeting. Dividends may be paid in cash, in property or in shares of stock of the Corporation, unless otherwise provided by law or the Corporation's certificate of incorporation.

SECTION 2. The seal of the Corporation shall be in such form as shall be approved by the board of directors.

SECTION 3. The fiscal year of the Corporation shall begin the first day of June in each year and end on the next succeeding 31st day of May, or otherwise as the board of directors shall determine.

SECTION 4. All checks, notes, drafts or other orders for the payment of money of the Corporation shall be signed, endorsed or accepted in the name of the Corporation by such officer, officers, person or persons as from time to time may be designated by the board of directors or by an officer or officers authorized by the board of directors to make such designation.

SECTION 5. The board of directors may authorize any officer or officers, agent or agents, in the name and on behalf of the Corporation to enter into or execute and deliver any and all deeds, bonds, mortgages, contracts and other obligations or instruments, and such authority may be general or confined to specific instances.

SECTION 6. Unless otherwise provided by resolution of the board of directors, the Chairman of the Board or the President, from time to time, may (or may appoint one or more attorneys or agents to) cast the votes which the Corporation may be entitled to cast as a stockholder or otherwise in any other corporation, any of whose shares or securities may be held by the corporation, at meetings of the holders of the shares or other securities of such other corporation. In the event one or more attorneys or agents are appointed, the Chairman of the Board or the President, may instruct the person or persons so appointed as to the manner of casting such votes or giving such consent. The Chairman of the Board or the President may, or may instruct the attorneys or agents appointed to, execute or cause to be executed in the name and on behalf of the Corporation and under its seal or otherwise, such written proxies, consents, waivers or other instruments as may be necessary or proper in the circumstances.

SECTION 7. All nouns and pronouns and any variations thereof used herein shall be deemed to refer to the masculine, feminine or neuter, singular or plural, as the context may require.

ARTICLE VIII

AMENDMENTS

SECTION 1. These by-laws may be amended, altered or repealed by the stockholders or by the board of directors.