

ADP (ADP)

\$176.87 (As of 01/17/20)

Price Target (6-12 Months): **\$188.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 05/07/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:C

Value: D

Growth: B

Momentum: A

Summary

ADP continues to enjoy a dominant position in the human capital management market through strategic acquisitions like Celergo, WorkMarket, Global Cash Card and The Marcus Buckingham Company. It has a strong business model, high recurring revenues, good margins, robust client retention and low capital expenditure. A solid balance sheet enables the company to continue with its shareholder-friendly activities alongside strategic buyouts and investments on product development. Due to these positives, shares of ADP have outperformed the industry in the past year. However, ADP faces significant competition in each of its product lines. Failure to remain technologically updated might reduce the demand for its solutions and services. The company is seeing increase in expenses as it continues to acquire companies and invest in transformation efforts.

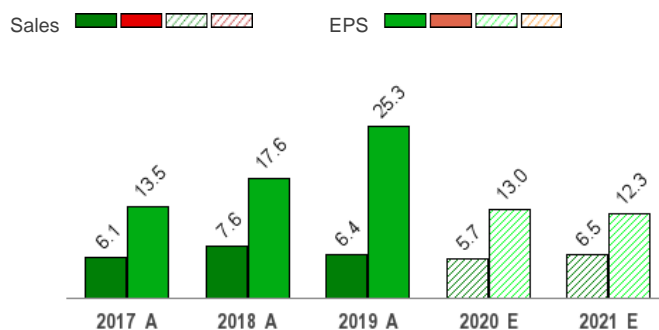
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$176.91 - \$132.04
20 Day Average Volume (sh)	1,301,863
Market Cap	\$76.5 B
YTD Price Change	3.7%
Beta	0.86
Dividend / Div Yld	\$3.64 / 2.1%
Industry	Outsourcing
Zacks Industry Rank	Bottom 35% (165 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.8%
Last Sales Surprise	-0.4%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	01/29/2020
Earnings ESP	0.0%
P/E TTM	31.6
P/E F1	28.7
PEG F1	2.2
P/S TTM	5.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	3,736 E	3,940 E	4,337 E	3,973 E	15,954 E
2020	3,496 A	3,683 E	4,084 E	3,724 E	14,986 E
2019	3,323 A	3,506 A	3,847 A	3,499 A	14,175 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.49 E	\$1.68 E	\$2.21 E	\$1.56 E	\$6.92 E
2020	\$1.34 A	\$1.45 E	\$1.98 E	\$1.39 E	\$6.16 E
2019	\$1.20 A	\$1.34 A	\$1.77 A	\$1.14 A	\$5.45 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/20/2020.

Overview

Automatic Data Processing, Inc. is one of the leading providers of cloud-based Human Capital Management (HCM) technology solutions - including payroll, talent management, Human Resources and benefits administration, and time and attendance management - to employers around the world. The company delivers its global HCM strategy and make investments in highly strategic areas and technology in order to strengthen its underlying business model and prospects for continued growth.

The company was founded in 1949, incorporated in the State of Delaware in June 1961 and completed its initial public offering in September 1961. The company serves more than 740,000 clients across 110 countries and territories.

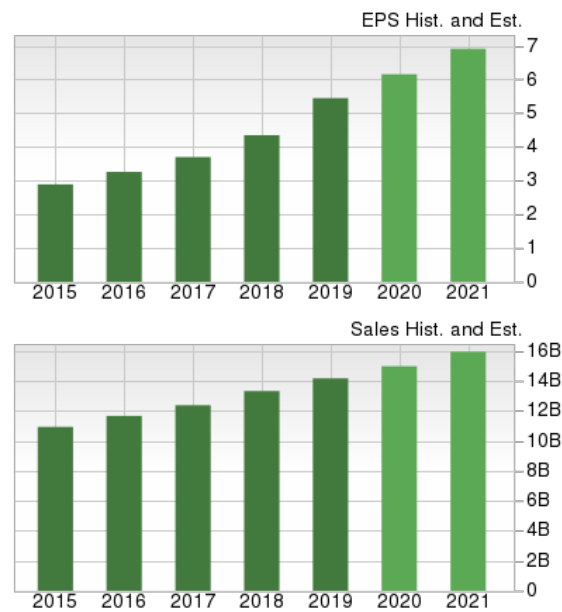
ADP has two reportable business segments – Employer Services and Professional Employer Organization (PEO) Services.

Employer Services: The Employer Services segment offers a comprehensive suite of HRO and technology-based HCM solutions which includes payroll services, benefits administration, talent management, HR management, time and attendance management, insurance services, retirement services and compliance services. The company mainly serves clients ranging from single-employee small businesses to large enterprises with tens of thousands of employees around the world.

In fiscal 2018, revenues from this segment increased 5% year over year on a reported basis and 4% on an organic constant currency basis.

Professional Employer Organization (PEO) Services: The Professional Employer Organization (PEO) Services segment provides small and medium-sized businesses with employment administration outsourcing solutions, including payroll, payroll tax filing, HR guidance, 401(k) plan administration, benefits administration, compliance services, health and workers' compensation coverage, and other supplemental benefits for the employees. Revenues from this segment grew 12% on a year over year basis in fiscal 2018.

ADP's PEO business, named ADP TotalSource is the largest PEO in the United States based on the number of worksite employees. It serves approximately 12,000 clients and more than 530,000 worksite employees across 50 states and operates as a certified PEO under the United States Internal Revenue Code.



Reasons To Buy:

- ▲ ADP has bolstered its stake in the global human capital management (HCM) market through **strategic acquisitions** like Celergo, WorkMarket, Global Cash Card and The Marcus Buckingham Company. These buyouts are strengthening ADP's customer base and helping it expand operations in international markets. The company continues to pursue acquisitions that strategically fit its overall business mix and are easy to integrate over the long term.
- ▲ ADP has a strong pipeline for new business bookings and it continues to innovate, improve operations and invest in the sales force. The company has a **strong business model**, high recurring revenues, good margins, robust client retention and low capital expenditure. Moreover, it has a strong cash generating ability that allows it to pursue growth in areas that exhibit true potential. Also, ADP has streamlined its business to strengthen its core-operations in the long run. These tailwinds have been benefiting the stock that has gained 33.5% over the past year, outperforming the 29.6% rally of the industry.
- ▲ ADP continues to innovate, improve operations and invest in its ongoing **transformation efforts**. As a part of its transformation initiative, ADP has launched differentiated "Next Gen" platforms aimed at strengthening its position in HCM innovation and improving its U.S. up-market and international product suite. ADP's other notable transformation-related achievements include accelerated DataCloud penetration, increased investment in inside sales, mid-market migrations, service alignment initiatives and voluntary early retirement program. ADP will soon expand its ongoing transformation through several broad-based initiatives. These include Go-To-Market Initiatives like data-enabled market insights and streamlined support, Service Initiatives encompassing automated service enabler tools and optimized service locations, Product & Portfolio Initiatives including ongoing client upgrades and infrastructure optimization, and Operations & Support Initiatives such as procurement and pay-for-performance programs. Transformation initiatives are allowing the company to expand margins and improve innovation abilities.
- ▲ ADP's **strong balance sheet** makes the stock attractive for investment in our view. ADP had cash and cash equivalents of \$1.4 billion as of Sep 30, 2019. It continues using excess cash to aggressively buy back shares and pay out dividends. In fiscal 2019, the company paid dividends worth \$1.29 billion and repurchased shares worth \$937.7 million. We believe that this strong cash position will not only help ADP to continue with its shareholder-friendly activities but also pursue strategic acquisitions and investments on product development in the long run.

ADP's acquisition strategy and initiatives to streamline and expand its business bode well.

Reasons To Sell:

- ▼ The outsourcing industry is labor intensive and heavily dependent on foreign talent. **Rising talent costs due to competition** coupled with Trump's stringent policies on immigration could curb the industry's growth. ADP, being one of the companies in the industry, is likely to get affected.
- ▼ ADP is seeing **increase in expenses** as it continues to acquire companies and invest in transformation efforts. PEO Services benefits pass-through costs and selling expenses are also on a rise. In fiscal 2019, ADP's total expenses of \$11.3 billion increased 3.7% year over year. Total expenses increased 7.7% year over year in fiscal 2018 and 6.2% in fiscal 2017. Hence, the bottom line is likely to remain under pressure going forward.
- ▼ ADP faces significant **competition** in each of its product lines. Both its Employer services and PEO services segments compete with other independent business outsourcing companies in most of their operating regions. Also, the company has seen some negative impact on its retention rate owing to the increasing competition and migration from the legacy business. Moreover, the company faces significant regulatory risks in the U.S. as well as in the international markets.
- ▼ ADP operates in industries, which are subject to rapid technological changes and **varying client demands**. To attract new clients and retain the existing ones, ADP should remain technologically updated. Failure to meet technological expectations might reduce the demand for its solutions and services, thus hampering its position in the market. The company's dependence on its payroll, financial, accounting, and other data processing systems remains a concern. Disruptions in any of these activities can hurt the company's overall operations, in terms of client loss, ill repute and so on.

Stiff competition and the pressure to remain technologically updated act as major headwinds for ADP.

Last Earnings Report

ADP Q3 Earnings Beat Estimates, Revenues Lag

ADP reported mixed first-quarter fiscal 2020 results, wherein the company's earnings surpassed the Zacks Consensus Estimate but revenues missed the same.

Adjusted earnings per share of \$1.34 beat the consensus mark by a penny and improved 12% year over year. Total revenues of \$3.49 billion missed the consensus mark by \$12.2 million but improved year over year.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	-0.35%
EPS Surprise	0.75%
Quarterly EPS	1.34
Annual EPS (TTM)	5.59

Segments in Detail

Employer Services revenues of \$2.44 billion increased 4% year over year on a reported basis and 5% on an organic constant-currency basis. The number of employees on ADP clients' payrolls in the United States rose 2.4%. New business bookings increased 6% in the reported quarter.

PEO Services revenues were up 8% year over year to \$1.06 billion. Average worksite employees paid by PEO Services were 563,000, up 7% from the prior-year quarter.

Interest on funds held for clients in the first quarter of fiscal 2020 increased 13% to \$134 million. The company's average client funds balance climbed 7% year over year to \$23.7 billion. Average interest yield on client funds was 2.3%, up 10 basis points (bps) on a year-over-year basis.

Margins

Adjusted EBIT came in at \$745 million, up 8% on a year-over-year basis. Adjusted EBIT margin rose 60 basis points from the year-ago quarter to 21.3%. Adjusted EBIT margin benefited from continued execution of transformation initiatives and operating efficiencies, which were partially offset by incremental sales and marketing, amortization, and PEO pass-through expenses.

Segment-wise, Employer Services' margin increased 50 bps on a year-over-year basis. The same for PEO Services declined 70 bps in the quarter.

Balance Sheet and Cash Flow

ADP exited first-quarter fiscal 2020 with cash and cash equivalents of \$1.40 billion compared with \$1.95 billion in the prior quarter. Long-term debt came in at \$1.00 billion compared with \$2.00 billion in the prior quarter.

The company generated \$432.8 million of net cash from operating activities in the reported quarter. Capital expenditures were \$56.8 million.

The company paid out dividends worth \$343.3 million and repurchased shares worth \$309.7 million.

Fiscal 2020 Outlook

ADP reaffirmed its guidance for fiscal 2020. Revenues are expected to register 6-7% growth. Adjusted earnings per share are anticipated to register 12-14% growth. The company expects adjusted EBIT margin growth of 100-125 bps.

Recent News

On **Nov 12, 2019**, ADP announced approval of a 12-cent increase in the quarterly cash dividend to an annual rate of \$3.64 per share. This marks the 45th consecutive year in which the company raised its quarterly dividend.

Valuation

ADP shares are up 33.5% over the trailing 12-month period. The Zacks sub-industry, sector and S&P 500 index are up 29.6%, 30.3% and 26.5%, respectively in the same time frame.

The stock is currently trading at 26.88X forward 12-month price-to-earnings, which compares to 23.41X for the Zacks sub-industry, 25.96X for the Zacks sector and 19.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.08X and as low as 21.81X, with a 5-year median of 25.94X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$188.00 price target reflects 28.57X price-to-earnings.

The table below shows summary valuation data for ADP.

Valuation Multiples - ADP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	26.88	23.41	25.96	19.2
	5-Year High	31.08	23.76	25.96	19.34
	5-Year Low	21.81	18.79	18.76	15.17
	5-Year Median	25.94	22.41	20.56	17.44
P/S F12M	Current	4.93	3.03	4.12	3.57
	5-Year High	5.11	3.03	5.13	3.57
	5-Year Low	2.86	2.23	3.09	2.54
	5-Year Median	3.61	2.55	3.63	3
P/B TTM	Current	14.28	8.52	5.08	4.55
	5-Year High	15.44	8.69	6.73	4.55
	5-Year Low	7.18	5.73	4.13	2.85
	5-Year Median	12.09	7.16	5.31	3.61

As of 01/17/2020

Industry Analysis Zacks Industry Rank: Bottom 35% (165 out of 254)



Top Peers

Aon plc (AON)	Neutral
Cognizant Technology Solutions Corporation (CTSH)	Neutral
DXC Technology Company. (DXC)	Neutral
CGI Group, Inc. (GIB)	Neutral
Marsh & McLennan Companies, Inc. (MMC)	Neutral
Paychex, Inc. (PAYX)	Neutral
PayPal Holdings, Inc. (PYPL)	Neutral
Square, Inc. (SQ)	Neutral

Industry Comparison Industry: Outsourcing				Industry Peers		
	ADP Neutral	X Industry	S&P 500	AON Neutral	CTSH Neutral	MMC Neutral
VGM Score	C	-	-	D	B	C
Market Cap	76.53 B	1.37 B	24.65 B	49.16 B	34.37 B	57.61 B
# of Analysts	11	2	13	8	12	8
Dividend Yield	2.06%	0.00%	1.73%	0.83%	1.27%	1.59%
Value Score	D	-	-	D	B	D
Cash/Price	0.07	0.11	0.04	0.02	0.09	0.02
EV/EBITDA	16.24	11.90	14.11	23.77	9.85	22.40
PEG Ratio	2.21	1.66	2.08	1.71	1.38	1.83
Price/Book (P/B)	14.28	4.01	3.39	13.93	3.23	7.39
Price/Cash Flow (P/CF)	20.71	14.18	13.81	18.31	12.73	21.15
P/E (F1)	28.71	19.65	19.19	20.46	15.20	22.36
Price/Sales (P/S)	5.33	1.02	2.69	4.51	2.07	3.58
Earnings Yield	3.48%	5.09%	5.21%	4.89%	6.58%	4.47%
Debt/Equity	0.19	0.35	0.72	1.72	0.13	1.47
Cash Flow (\$/share)	8.54	3.29	6.94	11.57	4.93	5.40
Growth Score	B	-	-	B	C	C
Hist. EPS Growth (3-5 yrs)	15.36%	12.28%	10.56%	10.42%	12.48%	12.17%
Proj. EPS Growth (F1/F0)	13.01%	12.94%	7.57%	13.38%	4.10%	9.86%
Curr. Cash Flow Growth	15.63%	10.68%	14.73%	7.57%	11.93%	8.07%
Hist. Cash Flow Growth (3-5 yrs)	14.63%	11.79%	9.00%	5.07%	14.81%	9.31%
Current Ratio	1.01	1.24	1.24	1.38	2.53	1.14
Debt/Capital	15.77%	28.68%	42.99%	63.22%	11.88%	59.45%
Net Margin	16.52%	1.67%	11.14%	13.79%	12.60%	9.34%
Return on Equity	46.94%	14.59%	17.16%	51.63%	20.23%	29.40%
Sales/Assets	0.34	1.10	0.55	0.38	1.05	0.56
Proj. Sales Growth (F1/F0)	5.72%	5.89%	4.16%	5.79%	3.11%	7.64%
Momentum Score	A	-	-	F	C	A
Daily Price Chg	1.14%	0.00%	0.27%	0.81%	0.51%	1.18%
1 Week Price Chg	0.66%	-0.14%	0.39%	0.04%	-1.17%	-0.16%
4 Week Price Chg	4.82%	1.99%	2.95%	1.01%	0.10%	1.73%
12 Week Price Chg	8.82%	5.44%	7.76%	10.72%	3.73%	15.65%
52 Week Price Chg	33.04%	21.63%	22.29%	38.92%	-5.68%	38.57%
20 Day Average Volume	1,301,863	153,295	1,536,375	620,721	2,304,580	1,213,750
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.02%
(F1) EPS Est 4 week change	-0.10%	0.00%	0.00%	0.01%	-0.08%	-0.05%
(F1) EPS Est 12 week change	0.00%	-0.20%	-0.40%	0.01%	-3.77%	-0.06%
(Q1) EPS Est Mthly Chg	-0.06%	0.00%	0.00%	0.00%	0.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	B
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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