ADP (ADP)

$137.06 (As of 03/26/20)

Price Target (6-12 Months): **$145.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/07/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:D
	Value: C | Growth: C | Momentum: C	

Summary

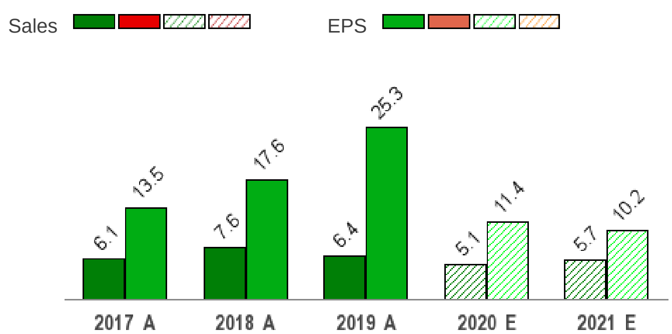
ADP continues to enjoy a dominant position in the human capital management market through strategic acquisitions like Celergo, WorkMarket, Global Cash Card and The Marcus Buckingham Company. It has a strong business model, high recurring revenues, good margins, robust client retention and low capital expenditure. A solid balance sheet enables the company to continue with its shareholder-friendly activities alongside strategic buyouts and investments on product development. 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. Partly due to these negatives, shares of ADP have declined over the past year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$182.32 - $103.11**
20 Day Average Volume (sh)	**4,125,775**
Market Cap	**$59.2 B**
YTD Price Change	**-19.6%**
Beta	**0.89**
Dividend / Div Yld	**$3.64 / 2.7%**
Industry	**Outsourcing**
Zacks Industry Rank	**Top 25% (62 out of 253)**
Last EPS Surprise	**4.8%**
Last Sales Surprise	**-0.3%**
EPS F1 Est- 4 week change	**-1.5%**
Expected Report Date	**04/29/2020**
Earnings ESP	**0.0%**
P/E TTM	**23.8**
P/E F1	**22.6**
PEG F1	**1.7**
P/S TTM	**4.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	3,727 E	3,924 E	4,322 E	3,956 E	15,747 E
2020	3,496 A	3,670 A	4,059 E	3,697 E	14,899 E
2019	3,323 A	3,506 A	3,847 A	3,499 A	14,175 A

EPS Estimates

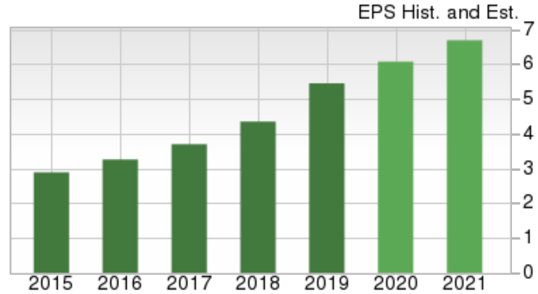
	Q1	Q2	Q3	Q4	Annual*
2021	$1.35 E	$1.58 E	$2.17 E	$1.62 E	$6.69 E
2020	$1.34 A	$1.52 A	$1.93 E	$1.34 E	$6.07 E
2019	$1.20 A	$1.34 A	$1.77 A	$1.14 A	$5.45 A

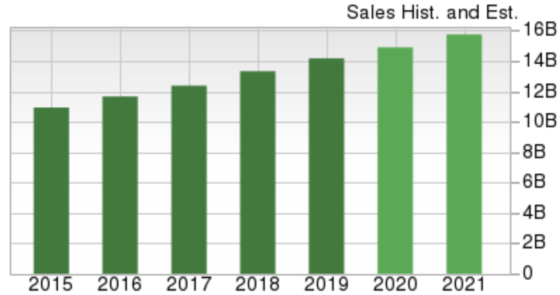
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/26/2020. The reports text is as of 03/27/2020.

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 it's 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 2019, revenues from this segment increased 5% year over year on a reported basis and 6% 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 increased 9% on a year over year basis in fiscal 2019.

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 12,500 clients and more than 562,000 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's acquisition strategy and initiatives to streamline and expand its business bode well.

▲ 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.

▲ ADP continues to innovate, improve operations and invest in its ongoing **transformation efforts**. As a part of its transformation initiative, the company 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 is expanding its 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 $1.5 billion as of Dec 31, 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.

Reasons To Sell:

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

- 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. This may weigh on its share price which has declined 12.5% over the past year compared with 16.8% decline of the industry it belongs to.

- 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.

Last Earnings Report

Automatic Data Processing Q2 Earnings Top Estimates

Quarter Ending	12/2019
Report Date	Jan 29, 2020
Sales Surprise	-0.26%
EPS Surprise	4.83%
Quarterly EPS	1.52
Annual EPS (TTM)	5.77

Automatic Data Processing reported mixed second-quarter fiscal 2020 results, wherein the company's earnings surpassed the Zacks Consensus Estimate but revenues missed the same.

Adjusted earnings per share of $1.52 beat the consensus mark by 4.8% and improved 13.4% year over year. Total revenues of $3.67 billion marginally missed the consensus mark of $3.68 billion but improved 5% year over year on a reported basis and 6% on a constant-currency basis.

Segments in Detail

Employer Services revenues of $2.54 billion increased 4% year over year on a reported as well as constant-currency basis. Pays per control rose 2.2% year over year. New business bookings increased 3%. PEO Services revenues were up 9% year over year to $1.13 billion. Average worksite employees paid by PEO Services were 579,000, up 6% from the prior-year quarter. Interest on funds held for clients increased 7% to $138 million. The company's average client funds balances climbed 6% year over year to $25.1 billion. Average interest yield on client funds was 2.2%, flat year over year.

Margins

Adjusted EBIT came in at $853.7 million, up 9% on a year-over-year basis. Adjusted EBIT margin rose 70 basis points from the year-ago quarter to 23.3%. 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.

Balance Sheet and Cash Flow

ADP exited the second quarter with cash and cash equivalents of $1.5 billion compared with $1.4 billion in the prior quarter. Long-term debt at the end of the quarter was $1 billion. The company generated $698.1 million of cash from operating activities in the quarter. Capital expenditures were $43.9 million. The company paid out dividends worth $342.7 million and repurchased shares worth $305.4 million.

Fiscal 2020 Outlook

ADP expects revenues to register about 6% growth. Adjusted earnings per share are anticipated to register 12-14% growth. The company expects adjusted EBIT margin growth of 100-125 basis points. Adjusted effective tax rate is anticipated to be 23.2%.

Recent News

On **Feb 11, 2020,** ADP announced expansion of ADP iHCM 2 in Philippines. ADP iHCM 2 is a human capital management system in the cloud that help user companies to reduce costs, increase talent engagement and unify operations.

On **Jan 21, 2020,** ADP announced that it has been named as one of the "World's Most Admired Companies" in 2020, by FORTUNE magazine.

Valuation

ADP shares are down 12.5% over the trailing 12-month period. The Zacks sub-industry, sector and S&P 500 index are up 16.8%, 8.4% and 12.5%, respectively in the same time frame.

The stock is currently trading at 20.46X forward 12-month price-to-earnings, which compares to 17.44X for the Zacks sub-industry, 20.67X for the Zacks sector and 14.92X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.08X and as low as 17.56X, with a 5-year median of 25.83X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $145.00 price target reflects 21.64X 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	20.46	17.44	20.67	14.92
	5-Year High	31.08	23.73	25.12	19.34
	5-Year Low	17.56	17.44	18.67	14.92
	5-Year Median	25.83	22.31	20.48	17.42
P/S F 12M	Current	3.79	2.23	3.25	2.68
	5-Year High	5.11	2.92	3.94	3.43
	5-Year Low	2.86	2.23	3.05	2.54
	5-Year Median	3.63	2.54	3.57	3
P/B TTM	Current	11.03	6.13	3.67	3.33
	5-Year High	15.44	8.69	6.68	4.56
	5-Year Low	7.18	4.9	3	2.85
	5-Year Median	12.21	7.2	5.18	3.63

As of 03/26/2020

Industry Analysis **Zacks Industry Rank:** Top 25% (62 out of 253)

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	D	-	-	B	B	C
Market Cap	59.18 B	754.01 M	18.50 B	38.37 B	27.33 B	43.26 B
# of Analysts	11	2	13	8	12	9
Dividend Yield	2.66%	0.00%	2.35%	1.06%	1.77%	2.12%
Value Score	C	-	-	D	B	C
Cash/Price	0.03	0.21	0.07	0.03	0.14	0.03
EV/EBITDA	13.21	6.01	11.16	16.07	8.19	14.64
PEG Ratio	1.74	1.02	1.74	NA	1.12	1.29
Price/Book (P/B)	11.03	1.98	2.44	11.15	2.48	5.46
Price/Cash Flow (P/CF)	16.05	7.01	9.87	13.88	9.89	14.31
P/E (F1)	22.58	11.91	15.29	15.98	12.35	17.00
Price/Sales (P/S)	4.08	0.70	1.93	3.48	1.63	2.60
Earnings Yield	4.43%	8.39%	6.47%	6.26%	8.09%	5.88%
Debt/Equity	0.25	0.31	0.70	1.92	0.13	1.35
Cash Flow ($/share)	8.54	3.40	7.01	11.94	5.04	6.00
Growth Score	C	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	16.45%	11.51%	10.85%	10.83%	11.62%	12.03%
Proj. EPS Growth (F1/F0)	11.44%	11.89%	2.89%	13.04%	1.13%	8.42%
Curr. Cash Flow Growth	15.63%	12.88%	5.93%	-0.54%	-2.96%	11.40%
Hist. Cash Flow Growth (3-5 yrs)	14.63%	12.37%	8.55%	3.75%	10.46%	9.25%
Current Ratio	1.02	1.24	1.23	1.52	2.55	1.06
Debt/Capital	20.26%	28.06%	42.57%	65.77%	11.59%	57.49%
Net Margin	16.97%	1.94%	11.64%	13.91%	10.98%	10.46%
Return on Equity	46.96%	16.81%	16.74%	55.95%	20.60%	29.72%
Sales/Assets	0.33	1.07	0.54	0.38	1.05	0.53
Proj. Sales Growth (F1/F0)	5.11%	4.61%	2.37%	5.00%	2.62%	7.08%
Momentum Score	C	-	-	A	B	C
Daily Price Chg	11.80%	7.37%	6.21%	1.56%	4.47%	-1.15%
1 Week Price Chg	-22.45%	-23.86%	-16.96%	-15.72%	-16.19%	-19.03%
4 Week Price Chg	-12.99%	-25.72%	-15.70%	-21.92%	-20.06%	-19.67%
12 Week Price Chg	-19.53%	-36.50%	-23.67%	-20.64%	-19.54%	-23.37%
52 Week Price Chg	-13.46%	-41.11%	-13.99%	-2.05%	-30.40%	-7.61%
20 Day Average Volume	4,125,775	353,429	4,286,768	2,989,266	6,105,628	4,174,836
(F1) EPS Est 1 week change	-0.43%	0.00%	-0.15%	-0.48%	-0.68%	-0.44%
(F1) EPS Est 4 week change	-1.52%	0.00%	-2.28%	-0.48%	-0.92%	-0.31%
(F1) EPS Est 12 week change	-1.39%	-1.43%	-3.22%	0.05%	-2.36%	-0.84%
(Q1) EPS Est Mthly Chg	-0.36%	0.00%	-1.60%	0.20%	-0.46%	-0.08%

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	C
Growth Score	C
Momentum Score	C
VGM Score	D

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.

Disclosures

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.