



# Automatic Data Processing (ADP)

Updated July 31<sup>st</sup>, 2021, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$210	<b>5 Year CAGR Estimate:</b>	6.5%	<b>Market Cap:</b>	\$88 B
<b>Fair Value Price:</b>	\$180	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	09/10/21 <sup>1</sup>
<b>% Fair Value:</b>	117%	<b>5 Year Valuation Multiple Estimate:</b>	-3.1%	<b>Dividend Payment Date:</b>	10/01/21
<b>Dividend Yield:</b>	1.8%	<b>5 Year Price Target</b>	\$264	<b>Years Of Dividend Growth:</b>	46
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	2.2%

## Overview & Current Events

Automatic Data Processing is one of the largest business services outsourcing companies in the world. The company provides payroll services, human resources technology, and other business operations to more than 700,000 corporate customers. Automatic Data Processing was founded in 1949 and currently trades with a market capitalization of \$88 billion, producing about \$16 billion in annual revenue. With 46 years of consecutive dividend increases, it is also a member of the prestigious Dividend Aristocrats Index.

ADP reported fourth quarter and full-year earnings on July 28<sup>th</sup>, 2021, with results slightly beating expectations for both profit and revenue. Revenue was up 11% year-over-year to \$3.7 billion, and was up 9% on an organic, constant currency basis. For the year, revenue increased 3% to \$15 billion, and the company posted 2% organic, constant currency revenue growth despite the impact of the pandemic.

Adjusted EBIT was up 4% to \$678 million in Q4, with EBIT margin falling 120bps on an adjusted basis to 18.1% of revenue. Higher revenues were offset by increases in selling expenses and other incentive compensation costs. For the quarter, net earnings were up 31% to \$538 million, and adjusted net earnings were up 4% to \$512 million.

Net earnings for the year were up 5% to \$2.6 billion, and on an adjusted basis, were up 1% to \$2.6 billion. On a fully diluted, adjusted per-share basis, earnings were up 2% to \$6.02.

ADP provided initial guidance for revenue growth of 6% to 7% for this year and adjusted diluted earnings-per-share growth of 9% to 11%. Given this, our initial estimate is for \$6.65 in earnings-per-share for fiscal 2022.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$2.82	\$2.80	\$3.11	\$2.89	\$3.25	\$3.70	\$4.53	\$5.45	\$5.92	\$6.02	<b>\$6.65</b>	<b>\$9.77</b>
<b>DPS</b>	\$1.55	\$1.70	\$1.88	\$1.95	\$2.08	\$2.24	\$2.50	\$3.06	\$3.52	\$3.70	<b>\$3.72</b>	<b>\$5.47</b>
<b>Shares<sup>2</sup></b>	491	484	483	466	456	445	439	436	429	424	<b>420</b>	<b>400</b>

Automatic Data Processing has compounded its adjusted earnings-per-share at a rate of nearly 9% per year over the last decade, which we believe it can come close to matching moving forward given that its recent earnings growth had been accelerating meaningfully prior to COVID-19. Beyond 2021, we believe the company is capable of delivering 8% annualized growth in earnings-per-share over full economic cycles, now that weakness from COVID-19 has passed.

Much of this growth is likely to be driven by the company's Professional Employer Organization (PEO) Services segment, which continues to deliver very impressive revenue growth. Importantly, this revenue growth has been accompanied by meaningful margin expansion, which means that the segment's growth has had an outsized impact on the firm's bottom line. In addition, the company's buyback has been a low single-digit tailwind annually for earnings-per-share growth in the past decade, and we expect that will continue moving forward. We see the company's fundamentals as very strong given recent results, excluding COVID-19-related weakness, and we think the company will grow at meaningful rates for a long time to come.

<sup>1</sup> Estimated date

<sup>2</sup> Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	18.7	18.7	21.8	24.5	29.0	26.0	27.0	27.1	26.8	27.7	31.6	27.0
Avg. Yld.	3.0%	2.9%	2.8%	2.5%	2.3%	2.5%	2.3%	2.1%	2.2%	2.2%	1.8%	2.1%

The stock has rallied since our last update and shares are again well in excess of our estimate of fair value. Shares trade for 31.6 times this year's earnings-per-share estimate, which compares unfavorably to our fair value estimate at 27 times earnings. That implies a headwind to total returns in the coming years. If the valuation multiple does decline, this will send the yield higher over time. We see the yield moving up from today's 1.8% to 2.1% in five years, in part thanks to strong forecasted dividend growth.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	55%	61%	61%	68%	64%	61%	55%	56%	59%	61%	56%	56%

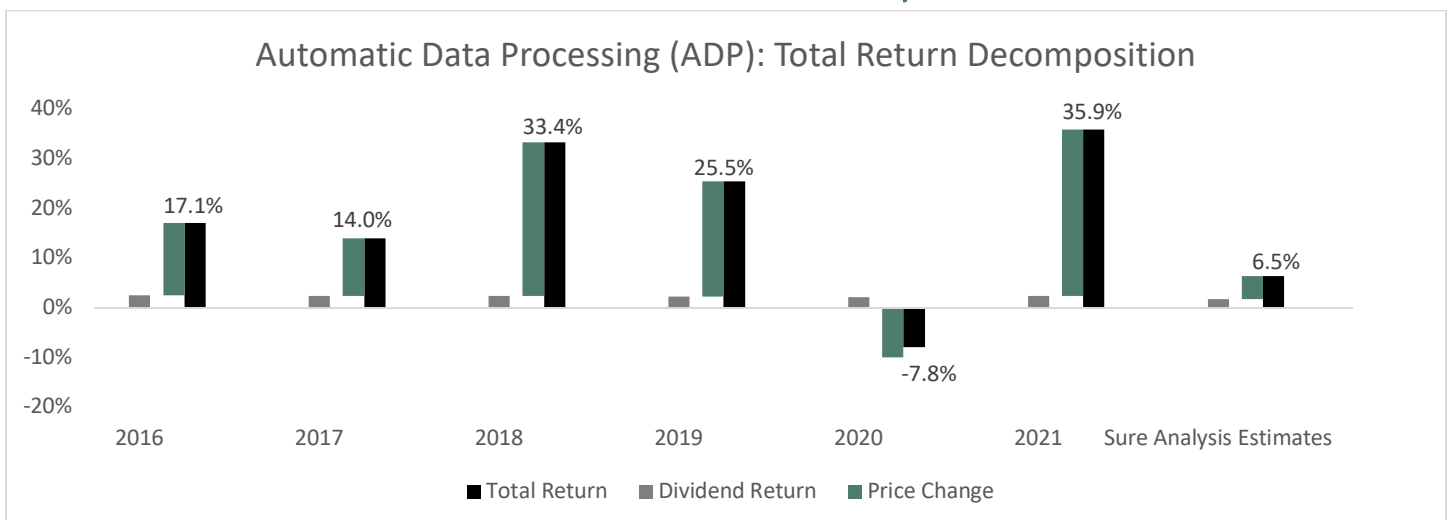
What immediately stands out about ADP's quality metrics is the high levels of debt. Fortunately, the vast majority of this debt is in the form of client fund obligations – money that is held by ADP before being paid out to the employees of its corporate customers. These client fund obligations are actually a source of competitive advantage, as they behave like insurance float and allow the company to invest the proceeds into low-risk investments and generate additional investment revenue. Indeed, the company's long-term debt is quite minimal, which leads to very high levels of interest coverage. Its scalable business model means that minimal additional assets are required to service the payroll needs of more customers. Accordingly, client fund obligations as a percentage of total assets will naturally expand over time.

Recessions will undoubtedly harm earnings potential given that ADP needs people to be employed, but it held up very well during the last recession and performed better than expected during the COVID recession. The rebound out of COVID conditions is well underway and ADP is firing on all cylinders out of what was a very short recession.

## Final Thoughts & Recommendation

Shares have rallied again since our last update, so we believe the value proposition of ADP has deteriorated. The stock is still overvalued in our view, but the company is rebounding quicker than expected heading into fiscal 2022. We continue to rate the stock a hold based upon its 6.5% projected annual total returns and exceptional dividend streak.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	10,595	9,442	10,226	10,939	11,668	12,372	13,328	14,175	14,590	15,005
<b>Gross Profit</b>	4,392	3,868	4,185	4,511	4,828	5,128	5,517	6,089	6,145	6,365
<b>Gross Margin</b>	41.4%	41.0%	40.9%	41.2%	41.4%	41.4%	41.4%	43.0%	42.1%	42.4%
<b>SG&amp;A Exp.</b>	2,453	2,200	2,370	2,497	2,637	2,774	2,959	3,064	3,003	3,041
<b>D&amp;A Exp.</b>	319	251	267	278	289	316	378	409	480	511
<b>Operating Profit</b>	1,939	1,668	1,815	2,014	2,191	2,354	2,557	3,024	3,142	3,325
<b>Operating Margin</b>	18.3%	17.7%	17.7%	18.4%	18.8%	19.0%	19.2%	21.3%	21.5%	22.2%
<b>Net Profit</b>	1,389	1,406	1,516	1,453	1,493	1,788	1,885	2,293	2,467	2,599
<b>Net Margin</b>	13.1%	14.9%	14.8%	13.3%	12.8%	14.5%	14.1%	16.2%	16.9%	17.3%
<b>Free Cash Flow</b>	1,661	1,342	1,518	1,639	1,511	1,655	2,044	2,122	2,410	2,587
<b>Income Tax</b>	727	588	637	694	741	829	398	713	716	763

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	30,817	32,268	32,060	33,111	43,670	37,180	38,849	41,888	39,166	48,773
<b>Cash &amp; Equivalents</b>	1,548	1,699	1,584	1,639	3,191	2,780	2,170	1,949	1,909	2,575
<b>Acc. Receivable</b>	1,315	1,516	1,415	1,547	1,743	1,704	1,984	2,439	2,441	2,727
<b>Goodwill &amp; Int.</b>	3,750	3,682	2,375	2,297	2,216	2,361	3,130	3,395	3,525	3,549
<b>Total Liabilities</b>	24,703	26,078	25,390	28,302	39,188	33,203	34,113	36,488	33,413	43,102
<b>Accounts Payable</b>	167	157	152	195	152	150	135	126	102	141
<b>Long-Term Debt</b>	17	15	2,185	9	2,008	2,002	2,002	2,002	2,005	2,985
<b>Total Equity</b>	6,114	6,190	6,670	4,809	4,482	3,977	4,736	5,400	5,752	5,670
<b>D/E Ratio</b>	0.00	0.00	0.33	0.00	0.45	0.50	0.42	0.37	0.35	0.53

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	4.3%	4.5%	4.7%	4.5%	3.9%	4.4%	5.0%	5.7%	6.1%	5.9%
<b>Return on Equity</b>	22.9%	22.9%	23.6%	25.3%	32.1%	42.3%	43.3%	45.2%	44.2%	45.5%
<b>ROIC</b>	22.8%	22.8%	20.1%	21.2%	26.4%	28.7%	29.6%	32.4%	32.5%	31.7%
<b>Shares Out.</b>	491	484	483	466	456	445	439	436	429	424
<b>Revenue/Share</b>	21.53	19.38	21.17	22.99	25.41	27.48	30.06	32.39	33.72	35.05
<b>FCF/Share</b>	3.37	2.76	3.14	3.44	3.29	3.68	4.61	4.85	5.57	6.04

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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