Automatic Data Processing (ADP)

Updated April 29th, 2023, by Josh Arnold

Key Metrics

Current Price:	$220	**5 Year CAGR Estimate:**	11.5%	**Market Cap:**	$91 B
Fair Value Price:	$236	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date:**	06/08/23
% Fair Value:	93%	**5 Year Valuation Multiple Estimate:**	1.4%	**Dividend Payment Date:**	07/01/23
Dividend Yield:	2.3%	**5 Year Price Target**	$347	**Years Of Dividend Growth:**	48
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Rating:**	Buy

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 $91 billion, producing annual revenue approaching $18 billion. With 48 years of consecutive dividend increases, it is also a member of the prestigious Dividend Aristocrats Index.

ADP reported third quarter earnings on April 26th, 2023, and results were better than expected on both the top and bottom lines, as is customary for the Dividend Aristocrat. The company posted adjusted earnings-per-share of $2.52, which was eight cents ahead of estimates. Earnings were up from $1.96 per share in Q2, and $2.21 in the year-ago period. Revenue was up 9% year-over-year to $4.9 billion, which was $20 million better than expected.

Expenses were $3.6 billion, up from $3.36 billion in Q2, and up from $3.35 billion in the year-ago period.

Revenue in the Employer Services segment rose 11% to $3.34 billion, while Professional Employer Organization revenue was up 5% year-over-year to $1.59 billion. Earnings for Employer Services were up 14% to $1.24 billion, while PEO earnings were up 15% to $261 million.

Guidance for the year was boosted as well, with forecast earnings-per-share growth now at 16% to 17%, implying ~$8.15 in earnings-per-share on an adjusted basis. That's where we've moved our estimate to following Q3 results. Revenue is forecast to rise nearly 10% as well.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$2.80	$3.11	$2.89	$3.25	$3.70	$4.53	$5.45	$5.92	$6.02	$7.01	*$8.15*	*$11.98*
DPS	$1.70	$1.88	$1.95	$2.08	$2.24	$2.50	$3.06	$3.52	$3.70	$4.05	*$5.00*	*$7.35*
Shares[1]	484	483	466	456	445	439	436	429	424	416	*410*	*380*

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 2023, we believe the company is capable of delivering 8% annualized growth in earnings-per-share over full economic cycles.

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, and we think the company will grow at meaningful rates for a long time to come. Growth has also recently picked up in Employer Services, adding to potential top and bottom line expansion.

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[1] Share count in millions

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	18.7	21.8	24.5	29.0	26.0	27.0	27.1	26.8	27.7	29.1	*27.0*	*29.0*
Avg. Yld.	2.9%	2.8%	2.5%	2.3%	2.5%	2.3%	2.1%	2.2%	2.2%	2.0%	*2.3%*	*2.1%*

ADP has traded with elevated valuations in recent years, near 30 times earnings. The stock now trades below our estimate of fair value. Shares trade for 27 times this year's earnings-per-share estimate, which compares favorably to our fair value estimate at 29 times earnings. That implies a small tailwind to total returns in the coming years from valuation expansion. We see the yield remaining just above 2.0% in five years, in part thanks to strong forecasted dividend growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	61%	61%	68%	64%	61%	55%	56%	59%	61%	58%	*61%*	*61%*

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 was impressive and ADP is firing on all cylinders out of what was a very short recession.

Final Thoughts & Recommendation

The company continues to see strong revenue and earnings estimates for this year. With 11.5% total projected returns, we're reiterating the stock at a buy rating. This stems from 8% earnings growth, a 2.3% dividend yield, and a 1.4% tailwind from the valuation.

Total Return Breakdown by Year

Automatic Data Processing (ADP): Total Return Decomposition
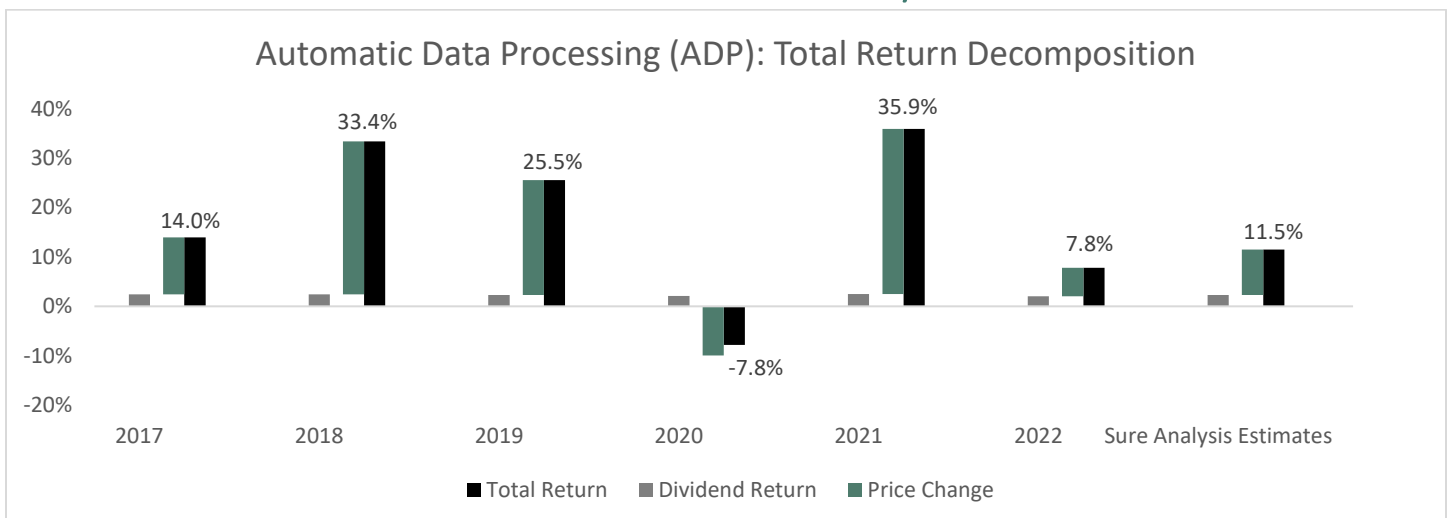
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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	9,442	10,226	10,939	11,668	12,372	13,328	14,175	14,590	15,005	16,047
Gross Profit	3,868	4,185	4,511	4,828	5,128	5,517	6,089	6,145	6,365	6,585
Gross Margin	41.0%	40.9%	41.2%	41.4%	41.4%	41.4%	43.0%	42.1%	42.4%	41.0%
SG&A Exp.	2,200	2,370	2,497	2,637	2,774	2,959	3,064	3,003	3,041	3,233
D&A Exp.	251	267	278	289	316	378	409	480	511	515
Operating Profit	1,668	1,815	2,014	2,191	2,354	2,557	3,024	3,142	3,325	3,351
Operating Margin	17.7%	17.7%	18.4%	18.8%	19.0%	19.2%	21.3%	21.5%	22.2%	20.9%
Net Profit	1,406	1,516	1,453	1,493	1,788	1,885	2,293	2,467	2,599	2,949
Net Margin	14.9%	14.8%	13.3%	12.8%	14.5%	14.1%	16.2%	16.9%	17.3%	18.4%
Free Cash Flow	1,342	1,518	1,639	1,511	1,655	2,044	2,122	2,410	2,587	2,546
Income Tax	588	637	694	741	829	398	713	716	763	855

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	32,268	32,060	33,111	43,670	37,180	38,849	41,888	39,166	48,773	63,068
Cash & Equivalents	1,699	1,584	1,639	3,191	2,780	2,170	1,949	1,909	2,575	1,436
Acc. Receivable	1,516	1,415	1,547	1,743	1,704	1,984	2,439	2,441	2,727	3,171
Goodwill & Int.	3,682	2,375	2,297	2,216	2,361	3,130	3,395	3,525	3,549	3,634
Total Liabilities	26,078	25,390	28,302	39,188	33,203	34,113	36,488	33,413	43,102	59,843
Accounts Payable	157	152	195	152	150	135	126	102	141	110
Long-Term Debt	15	2,185	9	2,008	2,002	2,002	2,002	2,005	2,985	3,124
Total Equity	6,190	6,670	4,809	4,482	3,977	4,736	5,400	5,752	5,670	3,225
LTD/E Ratio	0.00	0.33	0.00	0.45	0.50	0.42	0.37	0.35	0.53	0.97

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	4.5%	4.7%	4.5%	3.9%	4.4%	5.0%	5.7%	6.1%	5.9%	5.3%
Return on Equity	22.9%	23.6%	25.3%	32.1%	42.3%	43.3%	45.2%	44.2%	45.5%	66.3%
ROIC	22.8%	20.1%	21.2%	26.4%	28.7%	29.6%	32.4%	32.5%	31.7%	39.2%
Shares Out.	484	483	466	456	445	439	436	429	424	421
Revenue/Share	19.38	21.17	22.99	25.41	27.48	30.06	32.39	33.72	35.05	38.11
FCF/Share	2.76	3.14	3.44	3.29	3.68	4.61	4.85	5.57	6.04	6.05

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