



Automatic Data Processing (ADP)

Updated November 1st, 2023, by Josh Arnold

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|----------------------------------|-----------------------|
| Current Price: | \$218 | 5 Year CAGR Estimate: | 14.1% | Market Cap: | \$89 B |
| Fair Value Price: | \$265 | 5 Year Growth Estimate: | 8.0% | Ex-Dividend Date: | 12/08/23 ¹ |
| % Fair Value: | 82% | 5 Year Valuation Multiple Estimate: | 4.0% | Dividend Payment Date: | 01/05/24 |
| Dividend Yield: | 2.3% | 5 Year Price Target | \$390 | 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 \$89 billion, producing annual revenue of about \$19 billion. With 48 years of consecutive dividend increases, it is also a member of the prestigious Dividend Aristocrats Index.

ADP posted first quarter earnings on October 25th, 2023, and results were mixed as the company beat on the bottom line, but fractionally missed the top line. Adjusted earnings-per-share came to \$2.08, which was six cents better than expected. Revenue was up 7% year-over-year to \$4.5 billion, but missed estimates by \$10 million.

Employer Services grew 9%, which was driven by strong new business bookings and retention, as well as higher client funds interest revenue. PEO Services revenue rose 3% with new business bookings growth, but margins fell 90 basis points. This was due partly to workers' compensation reserve adjustments and higher selling costs. Total expenses were up 7.4% to \$3.48 billion.

We see \$9.15 in earnings-per-share for fiscal 2024 after first quarter results, which is a nickel higher than our prior estimate.

Growth on a Per-Share Basis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|----------------|
| EPS | \$3.11 | \$2.89 | \$3.25 | \$3.70 | \$4.53 | \$5.45 | \$5.92 | \$6.02 | \$7.01 | \$8.23 | \$9.15 | \$13.44 |
| DPS | \$1.88 | \$1.95 | \$2.08 | \$2.24 | \$2.50 | \$3.06 | \$3.52 | \$3.70 | \$4.05 | \$4.79 | \$5.00 | \$7.35 |
| Shares² | 483 | 466 | 456 | 445 | 439 | 436 | 429 | 424 | 416 | 412 | 405 | 375 |

Automatic Data Processing has compounded its adjusted earnings-per-share at a rate of more than 11% 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.

¹ Estimated date

² 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 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now | 2029 |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 21.8 | 24.5 | 29.0 | 26.0 | 27.0 | 27.1 | 26.8 | 27.7 | 29.1 | 26.7 | 23.8 | 29.0 |
| Avg. Yld. | 2.8% | 2.5% | 2.3% | 2.5% | 2.3% | 2.1% | 2.2% | 2.2% | 2.0% | 2.2% | 2.3% | 1.9% |

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 23.8 times this year's earnings-per-share estimate, which compares favorably to our fair value estimate at 29 times earnings. That implies a sizable tailwind to total returns in the coming years from valuation expansion. We see the yield remaining around 2.0% in five years, in part thanks to strong forecasted dividend growth, partly offset by a higher valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|---------------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 61% | 68% | 64% | 61% | 55% | 56% | 59% | 61% | 58% | 58% | 55% | 55% |

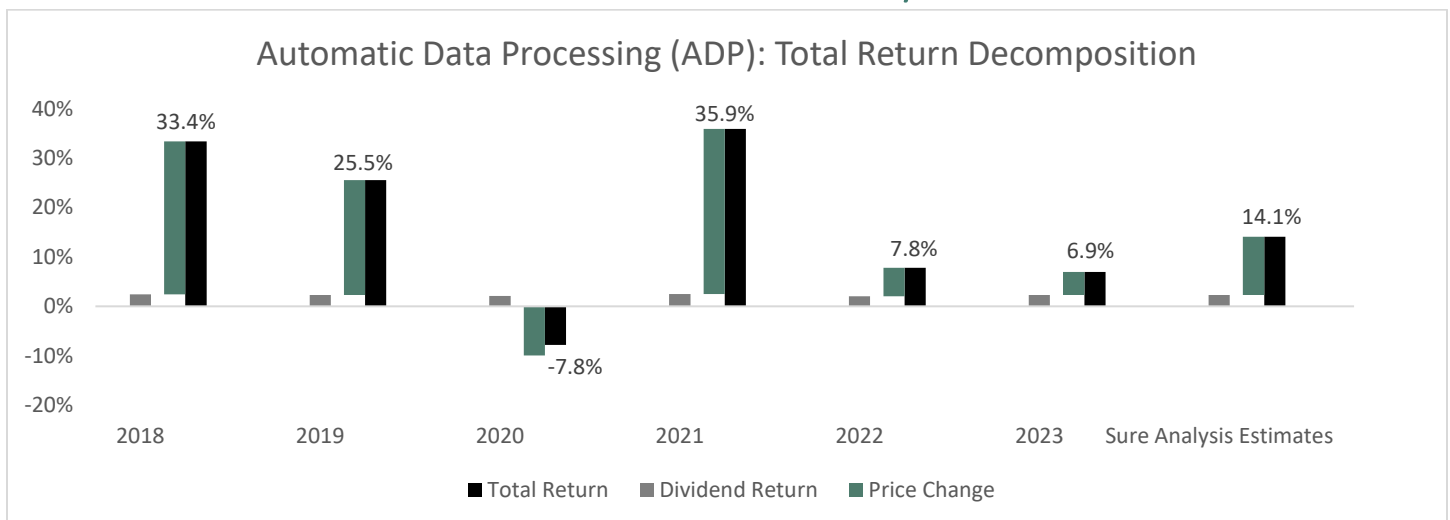
What immediately stands out about ADP's quality metrics is the high levels of debt. Fortunately, the vast majority of this debt is in the form of client fund obligations – money that is held by ADP before being paid out to the employees of its corporate customers. These client fund obligations are actually 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 14.1% 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 4% tailwind from the valuation.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Revenue | 10,226 | 10,939 | 11,668 | 12,372 | 13,328 | 14,175 | 14,590 | 15,005 | 16,047 | 17,199 |
| Gross Profit | 4,185 | 4,511 | 4,828 | 5,128 | 5,517 | 6,089 | 6,145 | 6,365 | 6,585 | 7,245 |
| Gross Margin | 40.9% | 41.2% | 41.4% | 41.4% | 41.4% | 43.0% | 42.1% | 42.4% | 41.0% | 42.1% |
| SG&A Exp. | 2,370 | 2,497 | 2,637 | 2,774 | 2,959 | 3,064 | 3,003 | 3,041 | 3,233 | 3,551 |
| D&A Exp. | 267 | 278 | 289 | 316 | 378 | 409 | 480 | 511 | 515 | 549 |
| Operating Profit | 1,815 | 2,014 | 2,191 | 2,354 | 2,557 | 3,024 | 3,142 | 3,325 | 3,351 | 3,694 |
| Operating Margin | 17.7% | 18.4% | 18.8% | 19.0% | 19.2% | 21.3% | 21.5% | 22.2% | 20.9% | 21.5% |
| Net Profit | 1,516 | 1,453 | 1,493 | 1,788 | 1,885 | 2,293 | 2,467 | 2,599 | 2,949 | 3,412 |
| Net Margin | 14.8% | 13.3% | 12.8% | 14.5% | 14.1% | 16.2% | 16.9% | 17.3% | 18.4% | 19.8% |
| Free Cash Flow | 1,518 | 1,639 | 1,511 | 1,655 | 2,044 | 2,122 | 2,410 | 2,587 | 2,546 | 3,636 |
| Income Tax | 637 | 694 | 741 | 829 | 398 | 713 | 716 | 763 | 855 | 1,026 |

Balance Sheet Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets | 32,060 | 33,111 | 43,670 | 37,180 | 38,849 | 41,888 | 39,166 | 48,773 | 63,068 | 50,971 |
| Cash & Equivalents | 1,584 | 1,639 | 3,191 | 2,780 | 2,170 | 1,949 | 1,909 | 2,575 | 1,436 | 2,084 |
| Acc. Receivable | 1,415 | 1,547 | 1,743 | 1,704 | 1,984 | 2,439 | 2,441 | 2,727 | 3,171 | 3,010 |
| Goodwill & Int. | 2,375 | 2,297 | 2,216 | 2,361 | 3,130 | 3,395 | 3,525 | 3,549 | 3,634 | 3,683 |
| Total Liabilities | 25,390 | 28,302 | 39,188 | 33,203 | 34,113 | 36,488 | 33,413 | 43,102 | 59,843 | 47,462 |
| Accounts Payable | 152 | 195 | 152 | 150 | 135 | 126 | 102 | 141 | 110 | 97 |
| Long-Term Debt | 2,185 | 9 | 2,008 | 2,002 | 2,002 | 2,002 | 2,005 | 2,985 | 3,124 | 2,989 |
| Total Equity | 6,670 | 4,809 | 4,482 | 3,977 | 4,736 | 5,400 | 5,752 | 5,670 | 3,225 | 3,509 |
| LTD/E Ratio | 0.33 | 0.00 | 0.45 | 0.50 | 0.42 | 0.37 | 0.35 | 0.53 | 0.97 | 0.85 |

Profitability & Per Share Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 4.7% | 4.5% | 3.9% | 4.4% | 5.0% | 5.7% | 6.1% | 5.9% | 5.3% | 6.0% |
| Return on Equity | 23.6% | 25.3% | 32.1% | 42.3% | 43.3% | 45.2% | 44.2% | 45.5% | 66.3% | 101% |
| ROIC | 20.1% | 21.2% | 26.4% | 28.7% | 29.6% | 32.4% | 32.5% | 31.7% | 39.2% | 53.7% |
| Shares Out. | 483 | 466 | 456 | 445 | 439 | 436 | 429 | 424 | 421 | 416 |
| Revenue/Share | 21.17 | 22.99 | 25.41 | 27.48 | 30.06 | 32.39 | 33.72 | 35.05 | 38.11 | 41.37 |
| FCF/Share | 3.14 | 3.44 | 3.29 | 3.68 | 4.61 | 4.85 | 5.57 | 6.04 | 6.05 | 8.75 |

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

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