



Automatic Data Processing (ADP)

Updated February 7th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$251	5 Year CAGR Estimate:	12.1%	Market Cap:	\$103 B
Fair Value Price:	\$265	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	03/07/24
% Fair Value:	95%	5 Year Valuation Multiple Estimate:	1.1%	Dividend Payment Date:	04/01/24
Dividend Yield:	2.2%	5 Year Price Target	\$408	Years Of Dividend Growth:	49
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 \$103 billion, producing annual revenue of about \$19 billion. With 49 years of consecutive dividend increases, it is also a member of the prestigious Dividend Aristocrats Index, and just one year away from being a Dividend King.

ADP posted second quarter earnings on January 31st, 2024, and results were quite strong. Adjusted earnings-per-share came to \$2.13, which was three cents ahead of estimates, and up 9% year-over-year. Net earnings were up 8% to \$878 million. Revenue was up 6.4% year-over-year to \$4.67 billion, and \$10 million ahead of estimates. The company saw organic constant currency revenue rise 6%.

Interest on funds held for clients rose 20% year-over-year to \$225 million, as market rates remain high relative to recent history. In addition, ADP's earnings are increasingly becoming dependent upon this interest on held funds, so it's worth watching closely for investors. Average client funds balances actually declined 2% to \$32.6 billion year-over-year, while the yield on those funds soared 50 basis points higher to 2.8%.

Adjusted EBIT was up 7% year-over-year to \$1.1 billion, with an adjusted EBIT margin that was up slightly to 24.6% of revenue.

We reiterate our estimate of \$9.15 in adjusted earnings-per-share for this year after Q2 results.

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	\$14.08
DPS	\$1.88	\$1.95	\$2.08	\$2.24	\$2.50	\$3.06	\$3.52	\$3.70	\$4.05	\$4.79	\$5.60	\$8.23
Shares¹	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 9% 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 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	27.4	29.0
Avg. Yld.	2.8%	2.5%	2.3%	2.5%	2.3%	2.1%	2.2%	2.2%	2.0%	2.2%	2.2%	2.0%

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 27.4 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%	61%	58%

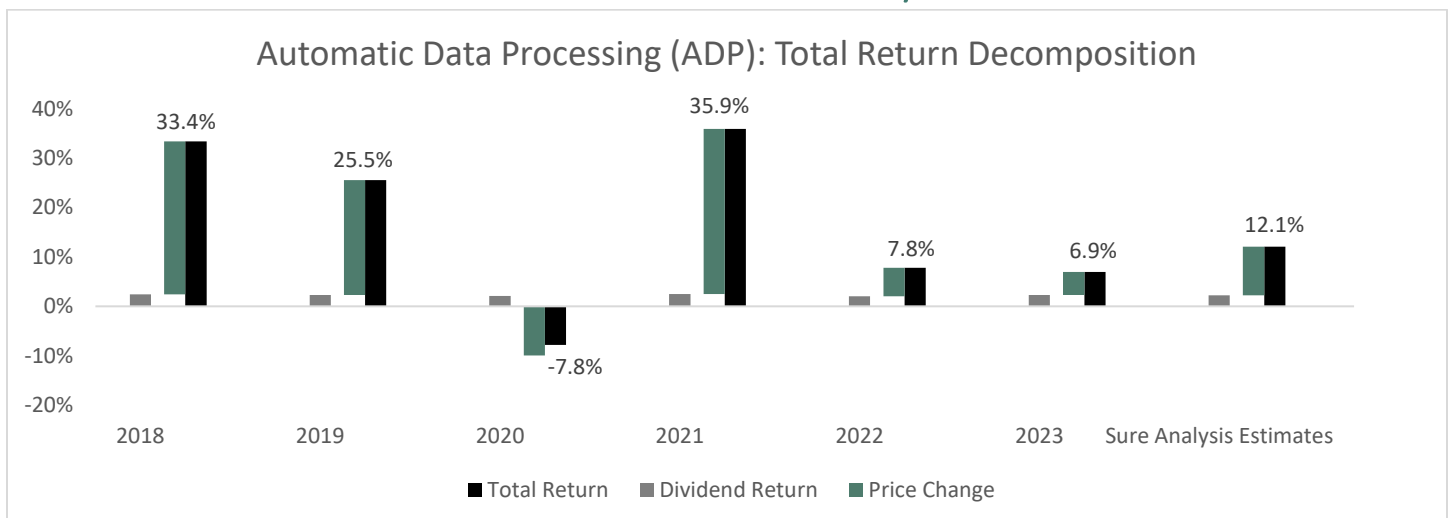
What immediately stands out about ADP's quality metrics is the high levels of debt. Fortunately, the vast majority of this debt is in the form of client fund obligations – money that is held by ADP before being paid out to the employees of its corporate customers. These client fund obligations are actually 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 12.1% total projected returns, we're reiterating the stock at a buy rating. This stems from 9% earnings growth, a 2.2% dividend yield, and a 1.1% 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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