

ADP

# Positive print, but better risk/reward elsewhere

Reiterate Rating: UNDERPERFORM | PO: 225.00 USD | Price: 251.90 USD

## Fundamentals are solid but valuation seems rich

ADP shares are trading higher following a solid F4Q with better-than-expected revenue retention and bookings growth as well as initial F24 guidance above Street. While consensus EPS is likely moving up by ~3%, we think valuation is stretched at 27x our new C24 EPS, especially when compared with Visa (V)/Mastercard (MA) at ~23x/~28x. While we do not see significant downside risk to ADP, we think upside is limited with the potential for both rising unemployment and lower interest rates. Reiterate Underperform.

## Overall F24 guidance better than expected

F24 revenues are expected to grow 6%-7% YoY (BofA/Street were at 6.7%/5.9%) with EBIT margins widening 60-80bps (BofAe was 20bps) due largely to higher float income (+19% YoY at midpoint, BofA/Street was +12%). Adj EPS are expected to grow 10%-12% YoY (BofA/Street were at ~9%) supported by buybacks. ADP's F24 guide anticipates a slight moderation in economic activity throughout the year.

## ES strength expected to continue in F24

F4Q Employer Services (ES) revenues grew 11% YoY vs Street ests of ~7.5% driven by core ES revenue growth of 7% YoY (BofA/Street ests were 5%/4%) and solid float income (+86% YoY, BofA/Street ests were +72%). In F24, ADP anticipates ES revenue growth of 7%-8% (BofAe/Street were ~5%) as well as bookings growth of 4%-7% (vs 10% in F23), a (50)-(70) bps decline in revenue retention (+10bps in F23), pricing of ~100bps (vs. ~150bps in F23) and pays-per-control (PPC) growth of 1%-2% (+5% in F23). Float income is expected to be \$955M-\$975M, a 19% YoY increase at the midpoint (BofA/Street ests were for 12% growth).

## PEO segment missed, outlook soft

F4Q Professional Employer Organization (PEO) revs growth was 4% vs. Street at 5%. While recent PEO booking trends have accelerated, the F24 PEO rev guide is for just 3%-5% YoY growth (vs. Street at 6% and medium-term target of 10%-12%) due to slowing PPC. However, PEO revs growth could exit F24 above the top end of the full year guide. F24 PEO margin guide is down 20-40bps YoY (BofAe was +50bps) due to higher selling expenses & tougher comps.

## PO to \$225, more details on F4Q, estimate changes within

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.01	8.23	9.13	10.08	11.17
GAAP EPS	7.00	8.21	9.13	10.08	11.17
EPS Change (YoY)	16.4%	17.4%	10.9%	10.4%	10.8%
Consensus EPS (Bloomberg)			8.92	9.85	NA
DPS	4.05	4.79	5.15	5.35	5.55
Valuation (Jun)					
P/E	36.1x	30.7x	27.7x	25.1x	22.6x
GAAP P/E	36.1x	30.8x	27.7x	25.1x	22.6x
Dividend Yield	1.6%	1.9%	2.0%	2.1%	2.2%
EV / EBITDA*	20.3x	17.4x	16.2x	15.5x	14.5x
Free Cash Flow Yield*	2.8%	3.8%	5.1%	5.3%	5.6%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

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26 July 2023

## Equity

### Key Changes

(US\$)	Previous	Current
Price Obj.	206.00	225.00
2024E Rev (m)	19,154.4	19,214.3
2025E Rev (m)	20,498.5	20,383.4
2026E Rev (m)	NA	21,621.1
2024E EPS	8.89	9.13
2025E EPS	9.86	10.08
2026E EPS	NA	11.17

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## Stock Data

Price	251.90 USD
Price Objective	225.00 USD
Date Established	26-Jul-2023
Investment Opinion	B-3-7
52-Week Range	201.46 USD - 274.92 USD
Mrkt Val (mn) / Shares Out (mn)	104,664 USD / 415.5
Average Daily Value (mn)	433.58 USD
BofA Ticker / Exchange	ADP / NAS
Bloomberg / Reuters	ADP US / ADP.OQ
ROE (2024E)	102.6%
Net Dbt to Eqty (Jun-2023A)	25.8%
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

# iQprofile<sup>SM</sup> ADP

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	31.7%	43.0%	46.6%	48.0%	49.4%
Return on Equity	66.3%	101.5%	102.6%	104.9%	105.2%
Operating Margin	23.1%	25.0%	26.4%	26.8%	27.3%
Free Cash Flow	2,925	4,001	5,358	5,607	5,906

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.1x	1.2x	1.5x	1.4x	1.4x
Asset Replacement Ratio	0.1x	0.1x	0.2x	0.2x	0.2x
Tax Rate	22.5%	23.1%	23.0%	23.5%	23.5%
Net Debt-to-Equity Ratio	48.1%	25.8%	43.1%	10.2%	-24.4%
Interest Cover	46.4x	17.8x	16.3x	23.6x	31.5x

## Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	16,498	18,012	19,214	20,383	21,621
% Change	9.9%	9.2%	6.7%	6.1%	6.1%
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	5,356	6,233	6,694	7,023	7,481
% Change	10.1%	16.4%	7.4%	4.9%	6.5%
Net Interest & Other Income	1	(70)	(209)	(152)	(106)
<b>Net Income (Adjusted)</b>	<b>2,950</b>	<b>3,419</b>	<b>3,748</b>	<b>4,067</b>	<b>4,427</b>
<b>% Change</b>	<b>14.4%</b>	<b>15.9%</b>	<b>9.6%</b>	<b>8.5%</b>	<b>8.9%</b>

## Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,949	3,412	3,748	4,067	4,427
Depreciation & Amortization	1,470	1,542	1,515	1,475	1,507
Change in Working Capital	(1,638)	(939)	210	188	104
Deferred Taxation Charge	37	(80)	(80)	(80)	(80)
Other Adjustments, Net	282	272	227	235	243
Capital Expenditure	(174)	(206)	(261)	(277)	(294)
<b>Free Cash Flow</b>	<b>2,925</b>	<b>4,001</b>	<b>5,358</b>	<b>5,607</b>	<b>5,906</b>
<b>% Change</b>	<b>0.4%</b>	<b>36.8%</b>	<b>33.9%</b>	<b>4.7%</b>	<b>5.3%</b>

## Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	1,436	2,084	1,353	2,584	4,075
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	53,369	40,087	41,110	42,349	43,337
Property, Plant & Equipment	653	681	695	744	795
Other Non-Current Assets	7,611	8,119	7,176	6,252	5,311
<b>Total Assets</b>	<b>63,068</b>	<b>50,971</b>	<b>50,334</b>	<b>51,929</b>	<b>53,517</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	55,159	42,768	41,752	43,092	44,092
Long-Term Debt	2,987	2,989	2,989	2,989	2,989
Other Non-Current Liabilities	1,697	1,705	1,798	1,887	1,981
<b>Total Liabilities</b>	<b>59,843</b>	<b>47,462</b>	<b>46,540</b>	<b>47,968</b>	<b>49,061</b>
<b>Total Equity</b>	<b>3,225</b>	<b>3,509</b>	<b>3,795</b>	<b>3,961</b>	<b>4,456</b>
<b>Total Equity &amp; Liabilities</b>	<b>63,068</b>	<b>50,971</b>	<b>50,334</b>	<b>51,929</b>	<b>53,517</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Payments, Processors & IT Services

## Company Description

Founded in 1949, Automatic Data Processing (ADP) is the world's largest payroll processor. ADP provides payroll services (64% of revenue), co-employment services (34% of revenue) and earns interest on funds held for clients (3% of revenue). In FY22 (ended June), ADP generated \$16.5bn in revenue. ADP has raised its dividend for 48 consecutive years.

## Investment Rationale

We rate ADP at Underperform. We view ADP's profitability and solid balance sheet / cash-flow profile favorably, however, we think the risks of rising unemployment and the expectation of lower rates are not properly discounted in the valuation.

## Stock Data

Average Daily Volume

1,721,251

## Quarterly Earnings Estimates

	2023	2024
Q1	1.86A	2.00E
Q2	1.96A	2.17E
Q3	2.52A	2.85E
Q4	1.89A	2.11E

## More on F4Q Print

- Revs of \$4,478M were ahead of BofA/Consensus ests of \$4,413/\$4,387 as solid performance in the ES segment outweighed continued softness in the PEO segment:
  - ES fee revenues of \$2,785M were 2.3%/3.1% ahead of BofAe/consensus ests of \$2,723/\$2,701
  - PEO segment revenues of \$1,457M were 1.0% below / in line with BofAe/consensus ests of \$1,472M/\$1,455M
  - Float income of \$236M was ahead of BofAe and consensus ests of \$218M
- Adjusted EBIT margin of 22.5% was up 270bps YoY and 50bps ahead of BofAe, aided by float upside
- Adjusted EPS of \$1.89 beat BofA/Consensus ests of \$1.81/\$1.83

## F24 strategic priorities

CEO Maria Black described three strategic priorities for ADP in F24:

1. Deliver leading Human Capital Management (HCM) tech that allows clients to navigate the entire employee lifecycle. ADP sees an opportunity to improve their offerings through organic and inorganic means and plans to expand their international presence by offering the Roll product to two countries in Europe beginning in F24.
2. Provide expertise to their customers. ADP expects generative artificial intelligence (AI) to play a key role in delivering a better client experience through targeted sales offerings and improved customer service.
3. Utilize ADP's unique scale to benefit clients. ADP plans to continue to grow internationally and domestically (both organically and inorganically) and that their insights will only grow more powerful as they continue to scale.

## Estimate changes, PO to \$225

We are raising our PO to \$225 (\$206 prior) due to higher estimates and our updated DCF (c. 3% terminal rate, 9% WACC unchanged). Our PO is based on a 50/50 blend of our DCF and a 23x multiple to our C24 EPS estimate (was 25x C23 prior). Following the print, we raise our F24 EPS estimate to \$9.13 from \$8.89.



## Price objective basis & risk

### ADP (ADP)

Our \$225 PO is based on a 50/50 combination of a 23x PE multiple to CY24 EPS and our DCF model. A 23x PE multiple represents an approximate 25% premium to the S&P 500, a slight discount to the 10 year average of about 40%. We think this reflects both the momentum ADP is experiencing in sales and retention, as well as the elevated risks of rising unemployment and lower rates. Our DCF uses an approximate 3% terminal rate and a 9% WACC.

Upside risks to our price objective are: 1) stronger than forecast economic / employment backdrop - ADP's business model is tied to cyclical swings in US private sector employment. 2) better than expected margin / new bookings performance and 3) ADP is perceived as a high-quality company than can comfortably endure the unprecedented pressures from the pandemic.

Downside risks to our price objective are: 1) while ADP has a defensive business model, its shares have been tied to cyclical swings in US private sector employment, 2) potential for new competitive entrants or disintermediation through technical innovation, and 3) potential regulatory changes.

## Analyst Certification

I, Jason Kupferberg, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Payments, Processors, Specialty Finance and IT services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Accenture Plc	ACN	ACN US	Jason Kupferberg
	American Express Company	AXP	AXP US	Mihir Bhatia
	Ares Capital Corporation	ARCC	ARCC US	Derek Hewett
	Ares Commercial Real Estate Corporation	ACRE	ACRE US	Derek Hewett
	Baring's BDC Inc	BBDC	BBDC US	Derek Hewett
	Blackrock TCP Capital Corp	TCPC	TCPC US	Derek Hewett
	Blackstone Mortgage Trust Inc	BXMT	BXMT US	Derek Hewett
	Block Inc	SQ	SQ US	Jason Kupferberg
	Blue Owl Capital Corporation	OBDC	OBDC US	Derek Hewett
	Bread Financial Holdings Inc	BFH	BFH US	Mihir Bhatia
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	CI&T	CINT	CINT US	Jason Kupferberg
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	DLocal	DLO	DLO US	Jason Kupferberg
	EngageSmart	ESMT	ESMT US	Jason Kupferberg
	Essent Group	ESNT	ESNT US	Mihir Bhatia
	Fidelity National Information Services	FIS	FIS US	Jason Kupferberg
	Fiserv Inc	FI	FI US	Jason Kupferberg
	FleetCor Technologies Inc.	FLT	FLT US	Mihir Bhatia
	Flywire	FLYW	FLYW US	Jason Kupferberg
	Global Payments Inc	GPN	GPN US	Jason Kupferberg
	Mastercard Inc	MA	MA US	Jason Kupferberg
	MGIC Investment Corp.	MTG	MTG US	Mihir Bhatia
	New Mountain Finance Corporation	NMFC	NMFC US	Derek Hewett
	Nuvei	NVEI	NVEI US	Jason Kupferberg
	Nuvei	YNVEI	NVEI CN	Jason Kupferberg
	OneMain Holdings, Inc.	OMF	OMF US	Mihir Bhatia
	PayPal Holdings Inc	PYPL	PYPL US	Jason Kupferberg
	Safehold, Inc	SAFE	SAFE US	Derek Hewett

**US - Payments, Processors, Specialty Finance and IT services Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Sixth Street Specialty Lending, Inc	TSLX	TSLX US	Derek Hewett
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	Telus International	TIXT	TIXT US	Cassie Chan
	Telus International	YTIXT	TIXT CN	Cassie Chan
	Toast	TOST	TOST US	Jason Kupferberg
	Visa Inc.	V	V US	Jason Kupferberg
	WEX Inc.	WEX	WEX US	Mihir Bhatia
<b>NEUTRAL</b>				
	Affirm Holdings	AFRM	AFRM US	Jason Kupferberg
	AGNC Investment Corp	AGNC	AGNC US	Derek Hewett
	Annaly Capital Management	NLY	NLY US	Derek Hewett
	Apollo Commercial Real Estate Finance	ARI	ARI US	Derek Hewett
	Bain Capital Specialty Finance, Inc.	BCSF	BCSF US	Derek Hewett
	Blackstone Secured Lending Fund	BXSL	BXSL US	Derek Hewett
	BrightSpire Capital Inc.	BRSP	BRSP US	Derek Hewett
	Capital One Financial	COF	COF US	Mihir Bhatia
	Discover Financial	DFS	DFS US	Mihir Bhatia
	Ellington Financial	EFC	EFC US	Derek Hewett
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	Goldman Sachs BDC, Inc.	GSBD	GSBD US	Derek Hewett
	Golub Capital BDC, Inc.	GBDC	GBDC US	Derek Hewett
	Jack Henry & Associates	JKHY	JKHY US	Jason Kupferberg
	Ladder Capital Corp	LADR	LADR US	Derek Hewett
	Marqeta	MQ	MQ US	Jason Kupferberg
	Paymentus	PAY	PAY US	Jason Kupferberg
	PennyMac Mortgage Investment Trust	PMT	PMT US	Derek Hewett
	SoFi Technologies Inc	SOFI	SOFI US	Mihir Bhatia
	Synchrony Financial	SYF	SYF US	Mihir Bhatia
	Thoughtworks	TWKS	TWKS US	Jason Kupferberg
	TPG Real Estate Finance Trust	TRTX	TRTX US	Derek Hewett
	TTEC Holdings	TTEC	TTEC US	Cassie Chan
<b>UNDERPERFORM</b>				
	ADP	ADP	ADP US	Jason Kupferberg
	Angel Oak Mortgage Inc.	AOMR	AOMR US	Derek Hewett
	CGI Inc.	GIB	GIB US	Jason Kupferberg
	CGI Inc.	YGIBA	GIB/A CN	Jason Kupferberg
	Cognizant Technology Solutions	CTSH	CTSH US	Jason Kupferberg
	Coinbase	COIN	COIN US	Jason Kupferberg
	DXC Technology	DXC	DXC US	Jason Kupferberg
	EPAM Systems	EPAM	EPAM US	Jason Kupferberg
	Guild Holdings Company	GHLD	GHLD US	Derek Hewett
	Invesco Mortgage Capital, Inc.	IVR	IVR US	Derek Hewett
	loanDepot Inc	LDI	LDI US	Derek Hewett
	MidCap Financial Investment Co	MFIC	MFIC US	Derek Hewett
	New York Mortgage Trust	NYMT	NYMT US	Derek Hewett
	Paychex	PAYX	PAYX US	Jason Kupferberg
	Radian Group Inc	RDN	RDN US	Mihir Bhatia
	Rocket Companies, Inc.	RKT	RKT US	Mihir Bhatia
	TaskUs	TASK	TASK US	Cassie Chan
	Western Union	WU	WU US	Jason Kupferberg

## **IQmethod<sup>SM</sup> Measures Definitions**

### **Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

### **Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

### **Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

### **Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

### **Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

### **Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +  
Other LT Liabilities  
Enterprise Value

### **Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

### **Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

### **Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

*IQmethod<sup>SM</sup>* is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of *IQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

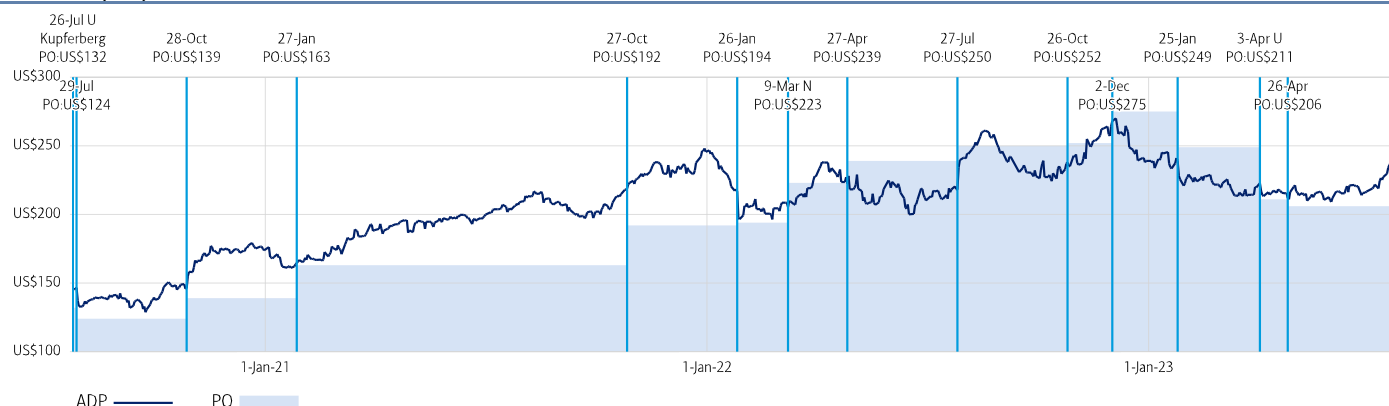
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# Disclosures

## Important Disclosures

### Automatic Data (ADP) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Technology Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	212	53.13%	Buy	103	48.58%
Hold	89	22.31%	Hold	45	50.56%
Sell	98	24.56%	Sell	30	30.61%

### Equity Investment Rating Distribution: Global Group (as of 30 Jun 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1877	53.28%	Buy	1040	55.41%
Hold	815	23.13%	Hold	464	56.93%
Sell	831	23.59%	Sell	385	46.33%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

**INCOME RATINGS**, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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