

ADP

PEO business spoils otherwise solid quarter

Reiterate Rating: UNDERPERFORM | PO: 217.00 USD | Price: 218.33 USD

PEO weakness + high multiple = selloff

ADP shares are trading lower following the F1Q print, due to a miss/guidedown in the PEO business. With shares trading at ~25x C24 P/E going into the print, there was little room for signs of weakness in the print, though we note the core Employer Services business performed well in the quarter. Ongoing challenges in PEO could keep shares in the near-term penalty box, with the potential for rising unemployment and interest rate cuts over the coming year likely to suppress upside to ests. Reiterate Underperform.

PEO guidance lowered modestly

PEO revs in F1Q grew 3% vs. 4% consensus. ADP lowered PEO segment guidance for F24 (Jun), which now calls for 3-4% revs growth vs. 3-5% prior, and 2-4% ex. zero-margin pass-throughs (3-5% prior). PEO margins are now expected to decline 50-100bps y/y in F24 vs. down 20-40bps prior. Average worksite employee (WSE) growth is now forecast at 2-3% vs. 3-4% prior. ADP has seen persistent softness in the professional services and tech verticals, which has impacted key PEO metrics. However, mgmt is optimistic that recent bookings/retention trends will support re-acceleration later in F24.

EPS beat on below the line items, slight miss on revs

ADP reported F1Q Adj. EPS of \$2.08, ahead of BofAe/Consensus at \$2.00/\$2.03. The beat vs. our model was driven by below the line items (about \$0.05 from net interest expense and \$0.03 from tax). Total revenues missed slightly, coming in at \$4,513M (BofAe/Street ests at \$4,524M/\$4,518M) driven by lower-than-expected PEO revenue.

ES still strong, new bookings off to a solid start

F1Q Employer Services (ES) revenues grew 9% YoY (8% on a constant currency basis), roughly in line with Street ests. The 9% was comprised of core ES revenue growth 7% YoY (in line with BofA/Street ests) and float income growth of 43% (BofA/Street ests were +50%/45%). ES margin was up 220 bps and PPC increased 2%, as expected. ADP also noted continued strength in new ES bookings, particularly in September, and maintained the 4%-7% guide for F24 growth, which could be conservative.

PO to \$217 from \$225

We lower our PO to \$217 from \$225. Our new target is based on 22x (vs. 23x prior to reflect persistent PEO challenges) our C24 EPS estimate of \$9.48 vs. \$9.56 prior.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.01	8.23	9.11	10.10	11.36
GAAP EPS	7.00	8.21	9.10	10.10	11.36
EPS Change (YoY)	16.4%	17.4%	10.7%	10.9%	12.5%
Consensus EPS (Bloomberg)			9.15	10.06	NA
DPS	4.05	4.79	5.15	5.35	5.55
Valuation (Jun)					
P/E	31.1x	26.5x	23.9x	21.6x	19.2x
GAAP P/E	31.1x	26.5x	23.9x	21.6x	19.2x
Dividend Yield	1.9%	2.2%	2.4%	2.5%	2.5%
EV / EBITDA*	17.3x	14.9x	13.9x	13.2x	12.3x
Free Cash Flow Yield*	3.2%	4.4%	5.5%	6.5%	6.8%

* For full definitions of *IQmethod*SM measures, see page 6.

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24 October 2023

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	225.00	217.00
2024E Rev (m)	19,214.3	19,157.8
2025E Rev (m)	20,383.4	20,497.2
2026E Rev (m)	21,621.1	21,929.8
2024E EPS	9.13	9.11
2025E EPS	10.08	10.10
2026E EPS	11.17	11.36

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Stock Data

Price	218.33 USD
Price Objective	217.00 USD
Date Established	25-Oct-2023
Investment Opinion	B-3-7
52-Week Range	201.46 USD - 274.92 USD
Mrkt Val (mn) / Shares Out (mn)	90,301 USD / 413.6
Average Daily Value (mn)	296.32 USD
BofA Ticker / Exchange	ADP / NAS
Bloomberg / Reuters	ADP US / ADP.OQ
ROE (2024E)	96.5%
Net Dbt to Eqty (Jun-2023A)	25.8%
ESGMeter TM	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.

iQprofileSM ADP

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	31.7%	43.0%	45.2%	46.3%	47.7%
Return on Equity	66.3%	101.5%	96.5%	93.4%	93.4%
Operating Margin	23.1%	25.0%	26.2%	26.8%	27.4%
Free Cash Flow	2,925	4,001	4,925	5,821	6,143

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.1x	1.2x	1.4x	1.5x	1.4x
Asset Replacement Ratio	0.1x	0.1x	0.1x	0.1x	0.1x
Tax Rate	22.5%	23.1%	22.8%	23.0%	23.0%
Net Debt-to-Equity Ratio	48.1%	25.8%	23.0%	-17.2%	-43.0%
Interest Cover	46.4x	17.8x	17.0x	23.8x	32.2x

Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	16,498	18,012	19,158	20,497	21,930
% Change	9.9%	9.2%	6.4%	7.0%	7.0%
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	5,356	6,233	6,692	7,014	7,522
% Change	10.1%	16.4%	7.4%	4.8%	7.2%
Net Interest & Other Income	1	(70)	(165)	(151)	(106)
Net Income (Adjusted)	2,950	3,419	3,756	4,115	4,546
% Change	14.4%	15.9%	9.9%	9.6%	10.5%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,949	3,412	3,753	4,115	4,546
Depreciation & Amortization	1,470	1,542	1,533	1,439	1,432
Change in Working Capital	(1,638)	(939)	(426)	206	107
Deferred Taxation Charge	37	(80)	(33)	(33)	(33)
Other Adjustments, Net	282	272	265	273	281
Capital Expenditure	(174)	(206)	(167)	(179)	(191)
Free Cash Flow	2,925	4,001	4,925	5,821	6,143
% Change	0.4%	36.8%	23.1%	18.2%	5.5%

Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	1,436	2,084	2,009	3,772	5,225
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	53,369	40,087	41,143	42,396	43,416
Property, Plant & Equipment	653	681	617	601	600
Other Non-Current Assets	7,611	8,119	7,507	6,638	5,777
Total Assets	63,068	50,971	51,276	53,407	55,018
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	55,159	42,768	42,320	44,089	44,943
Long-Term Debt	2,987	2,989	2,990	2,990	2,990
Other Non-Current Liabilities	1,697	1,705	1,692	1,789	1,891
Total Liabilities	59,843	47,462	47,002	48,868	49,824
Total Equity	3,225	3,509	4,274	4,539	5,194
Total Equity & Liabilities	63,068	50,971	51,276	53,407	55,018

* For full definitions of iQmethodSM 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

1,357,227

Quarterly Earnings Estimates

	2023	2024
Q1	1.86A	2.08A
Q2	1.96A	2.00E
Q3	2.52A	2.93E
Q4	1.89A	2.10E

PEO: Professional Employer Organization



Price objective basis & risk

ADP (ADP)

Our \$217 PO is based on a 50/50 combination of a 22x PE multiple to CY24E EPS and our DCF model. A 22x 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
BUY				
	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
	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
	Carlyle Secured Lending Inc	CGBD	CGBD US	Derek Hewett
	Compass Diversified Holdings	CODI	CODI US	Derek Hewett
	Crescent Capital BDC	CCAP	CCAP US	Derek Hewett
	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
	NMI Holdings	NMIH	NMIH US	Mihir Bhatia
	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
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Sixth Street Specialty Lending, Inc	TSIX	TSIX US	Derek Hewett
	Starwood Property Trust	STWD	STWD US	Derek Hewett
	Telus International	TIXT	TIXT US	Cassie Chan

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

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Telus International	YTXT	TIXT CN	Cassie Chan
	Toast	TOST	TOST US	Jason Kupferberg
	Visa Inc.	V	V US	Jason Kupferberg
	WEX Inc.	WEX	WEX US	Mihir Bhatia
NEUTRAL				
	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
	Bread Financial Holdings Inc	BFH	BFH US	Mihir Bhatia
	BrightSpire Capital Inc.	BRSP	BRSP US	Derek Hewett
	Capital One Financial	COF	COF US	Mihir Bhatia
	Discover Financial	DFS	DFS US	Mihir Bhatia
	DLocal	DLO	DLO US	Jason Kupferberg
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	Globant SA	GLOB	GLOB US	Jason Kupferberg
	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
	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 RE Finance Trust, Inc.	TRTX	TRTX US	Derek Hewett
	TTEC Holdings	TTEC	TTEC US	Cassie Chan
UNDERPERFORM				
	ADP	ADP	ADP US	Jason Kupferberg
	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
	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

IQmethodSM 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

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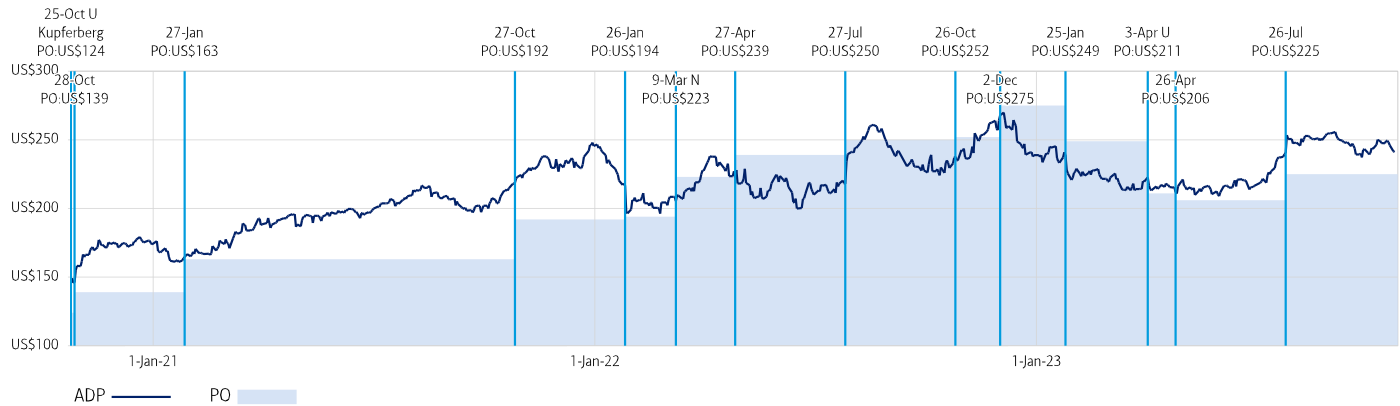
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Disclosures

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 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	204	51.52%	Buy	104	50.98%
Hold	95	23.99%	Hold	45	47.37%
Sell	97	24.49%	Sell	27	27.84%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

^{R1} 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.

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

^{R2} 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.

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