

ADP

Risk/reward now more balanced; upgrade to Neutral

Rating Change: NEUTRAL | PO: 243.00 USD | Price: 235.28 USD

Shares lagged heavily the past year; fundamentals stable

We upgrade ADP to Neutral from Underperform on more balanced risk/reward. Over the past year, shares have lagged the S&P500 by ~2,400bps, as anticipated tailwinds from employment and interest rates have waned. We hesitate to get more constructive given the 25x C24 P/E and limited upside potential to estimates. In the core ES business, we believe trends remain generally stable. Worst is likely over in the smaller PEO segment.

F2Q likely to be trough for growth and margins

ADP reports F2Q on 1/31. Last quarter management suggested F2Q will be the trough for revs growth (BofAe=+5.6% y/y vs. Street =+6.0%) and EBIT margins (BofAe= -20bps y/y vs. Street -4bps and guide for modest decline). Strength in F1Q ES bookings and retention along with an incrementally better macro could drive a modest F24 guidance raise for these metrics. Our F2Q EPS estimate of \$2.11 is in line with consensus.

PEO poised for potential F2H improvement

Revs growth in the PEO segment (30-35% of total revs) has been challenged in recent quarters due to a combination of post-pandemic normalization and layoffs in the professional services & tech verticals. However, ADP's National Employment Report suggests that trends in these verticals stabilized during C4Q (Ex. 1). In addition, on the F1Q call management cited three straight quarters of solid PEO bookings, which along with easier comps should promote F2H re-acceleration of PEO revs growth.

Still prefer networks over payroll processors

We maintain our preference for Buy-rated V and MA over ADP as well as Underperform-rated PAYX. In our view, V/MA have sturdier competitive moats, longer-duration secular tailwinds, and higher P&L growth rates, all at just a modest valuation premium to ADP/PAYX. Prefer ADP vs. PAYX given PAYX's SMB concentration.

PO to \$243 from \$217

Our new PO of \$243 (vs. \$217 prior) is based on a blend of 24x our unchanged F25 (Jun) EPS, vs. 22x C24 P/E prior, and our DCF. We are comfortable now basing our PO on F25 given the general stability in ADP's fundamentals.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	7.01	8.23	9.12	10.09	11.35
GAAP EPS	7.00	8.21	9.11	10.09	11.35
EPS Change (YoY)	16.4%	17.4%	10.8%	10.6%	12.5%
Consensus EPS (Bloomberg)			9.13	10.00	10.96
DPS	4.05	4.79	5.15	5.35	5.55
Valuation (Jun)					
P/E	33.6x	28.6x	25.8x	23.3x	20.7x
GAAP P/E	33.6x	28.7x	25.8x	23.3x	20.7x
Dividend Yield	1.7%	2.0%	2.2%	2.3%	2.4%
EV / EBITDA*	18.8x	16.2x	15.0x	14.4x	13.4x
Free Cash Flow Yield*	3.0%	4.1%	4.3%	4.8%	5.2%

* For full definitions of *IQmethod*SM measures, see page 5.

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Timestamp: 17 January 2024 06:00AM EST

17 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	B-3-7	B-2-7
Inv. Rating	UNDERPERFORM	NEUTRAL
Price Obj.	217.00	243.00

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Stock Data

Price	235.28 USD
Price Objective	243.00 USD
Date Established	16-Jan-2024
Investment Opinion	B-2-7
52-Week Range	201.46 USD - 256.84 USD
Mkt Val (mn) / Shares Out (mn)	97,312 USD / 413.6
Free Float	99.6%
Average Daily Value (mn)	428.18 USD
BofA Ticker / Exchange	ADP / NAS
Bloomberg / Reuters	ADP US / ADP.OQ
ROE (2024E)	105.8%
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".

See page 3 for abbreviations

iQprofileSM ADP

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	31.7%	43.0%	47.1%	52.8%	60.4%
Return on Equity	66.3%	101.5%	105.8%	124.6%	157.2%
Operating Margin	23.1%	25.0%	26.2%	26.8%	27.4%
Free Cash Flow	2,925	4,001	4,216	4,659	5,084

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.1x	1.2x	1.2x	1.2x	1.2x
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%	46.9%	36.4%	24.9%
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	19,175	20,491	21,932
% Change	9.9%	9.2%	6.5%	6.9%	7.0%
Gross Profit	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
EBITDA	5,356	6,233	6,697	7,009	7,521
% Change	10.1%	16.4%	7.4%	4.7%	7.3%
Net Interest & Other Income	1	(70)	(165)	(151)	(106)
Net Income (Adjusted)	2,950	3,419	3,761	4,111	4,545
% Change	14.4%	15.9%	10.0%	9.3%	10.5%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,949	3,412	3,758	4,111	4,545
Depreciation & Amortization	1,470	1,542	1,533	1,439	1,432
Change in Working Capital	(1,638)	(939)	(1,141)	(952)	(951)
Deferred Taxation Charge	37	(80)	(33)	(33)	(33)
Other Adjustments, Net	282	272	265	273	281
Capital Expenditure	(174)	(206)	(167)	(178)	(191)
Free Cash Flow	2,925	4,001	4,216	4,659	5,084
% Change	0.4%	36.8%	5.4%	10.5%	9.1%
Share / Issue Repurchase	(1,873)	(1,030)	(935)	(1,922)	(1,928)
Cost of Dividends Paid	(1,659)	(1,904)	(2,115)	(2,169)	(2,211)
Change in Debt	(1)	(1)	0	0	0

Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	1,436	2,084	1,299	1,901	2,295
Trade Receivables	NA	NA	NA	NA	NA
Other Current Assets	53,369	40,087	41,189	42,554	43,623
Property, Plant & Equipment	653	681	617	601	600
Other Non-Current Assets	7,611	8,119	7,508	6,638	5,776
Total Assets	63,068	50,971	50,612	51,694	52,294
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	55,159	42,768	42,324	43,968	44,688
Long-Term Debt	2,987	2,989	2,990	2,990	2,990
Other Non-Current Liabilities	1,697	1,705	1,694	1,741	1,829
Total Liabilities	59,843	47,462	47,008	48,699	49,507
Total Equity	3,225	3,509	3,604	2,995	2,787
Total Equity & Liabilities	63,068	50,971	50,612	51,694	52,294

* For full definitions of iQmethodSM measures, see page 5.

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 (62% of revenue), co-employment services (33% of revenue) and earns interest on funds held for clients (5% of revenue). In FY23 (ended June), ADP generated \$18bn in revenue. ADP has raised its dividend for 49 consecutive years.

Investment Rationale

We rate ADP at Neutral. We view ADP's profitability and solid balance sheet / cash-flow profile favorably, and now believe the risks of rising unemployment and the expectation of lower rates are more appropriately discounted in the valuation following LTM underperformance.

Stock Data

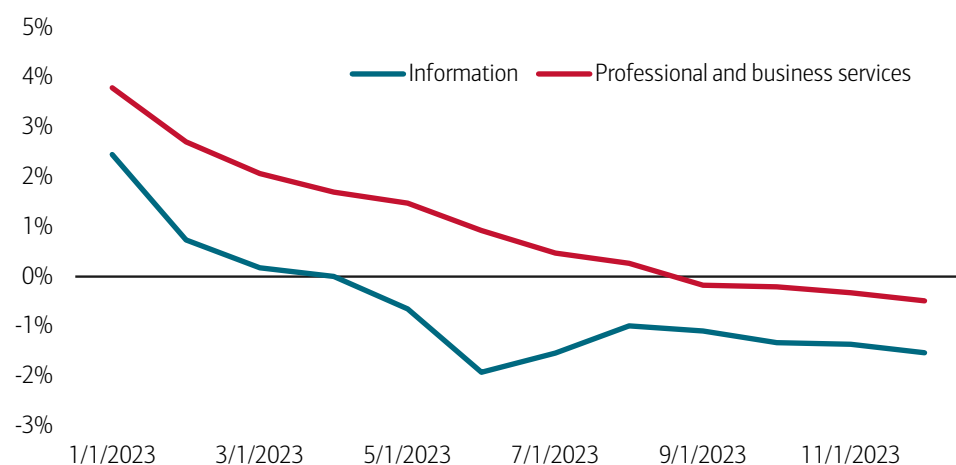
Average Daily Volume 1,819,891

Quarterly Earnings Estimates

	2023	2024
Q1	1.86A	2.08A
Q2	1.96A	2.11E
Q3	2.52A	2.88E
Q4	1.89A	2.05E

Exhibit 1: Headcount in information (tech) and professional services verticals has stabilized over the past few months

YoY % change in U.S. private employment by industry



Source: ADP National Employment Report

BofA GLOBAL RESEARCH

ES: Employer Services

PEO: Professional Employer Organization

SMB: small and midsize business

V: Visa

MA: Mastercard

PAYX: Paychex



Price objective basis & risk

ADP (ADP)

Our \$243 PO is based on a 50/50 combination of a 24x PE multiple to FY25E EPS and our DCF model. Our 24x PE multiple represents a premium of nearly 30% premium to the S&P 500, consistent with ADP's long-term average. We think this is appropriate as we balance the general stability in ADP's core business with the current cycle for employment and 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
	Block Inc	SQ	SQ US	Jason Kupferberg
	Capital One Financial	COF	COF US	Mihir Bhatia
	Discover Financial	DFS	DFS US	Mihir Bhatia
	Enact Holdings	ACT	ACT US	Mihir Bhatia
	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
	Jack Henry & Associates	JKHY	JKHY US	Jason Kupferberg
	Mastercard Inc	MA	MA US	Jason Kupferberg
	MGIC Investment Corp.	MTG	MTG US	Mihir Bhatia
	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
	Shift4 Payments, Inc	FOUR	FOUR US	Jason Kupferberg
	Telus International	TIXT	TIXT US	Cassie Chan
	Telus International	YTIXT	TIXT CN	Cassie Chan
	Visa Inc.	V	V US	Jason Kupferberg
	WEX Inc.	WEX	WEX US	Mihir Bhatia
NEUTRAL				
	ADP	ADP	ADP US	Jason Kupferberg
	Affirm Holdings	AFRM	AFRM US	Jason Kupferberg
	Bread Financial Holdings Inc	BFH	BFH US	Mihir Bhatia
	DLocal	DLO	DLO US	Jason Kupferberg
	Global Blue	GB	GB US	Mihir Bhatia
	Globant SA	GLOB	GLOB US	Jason Kupferberg

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

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Marqeta	MQ	MQ US	Jason Kupferberg
	PayPal Holdings Inc	PYPL	PYPL US	Jason Kupferberg
	SoFi Technologies Inc	SOFI	SOFI US	Mihir Bhatia
	Synchrony Financial	SYF	SYF US	Mihir Bhatia
	Thoughtworks	TWKS	TWKS US	Jason Kupferberg
	Toast	TOST	TOST US	Jason Kupferberg
	TTEC Holdings	TTEC	TTEC US	Cassie Chan

UNDERPERFORM

	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
	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

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

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

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

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

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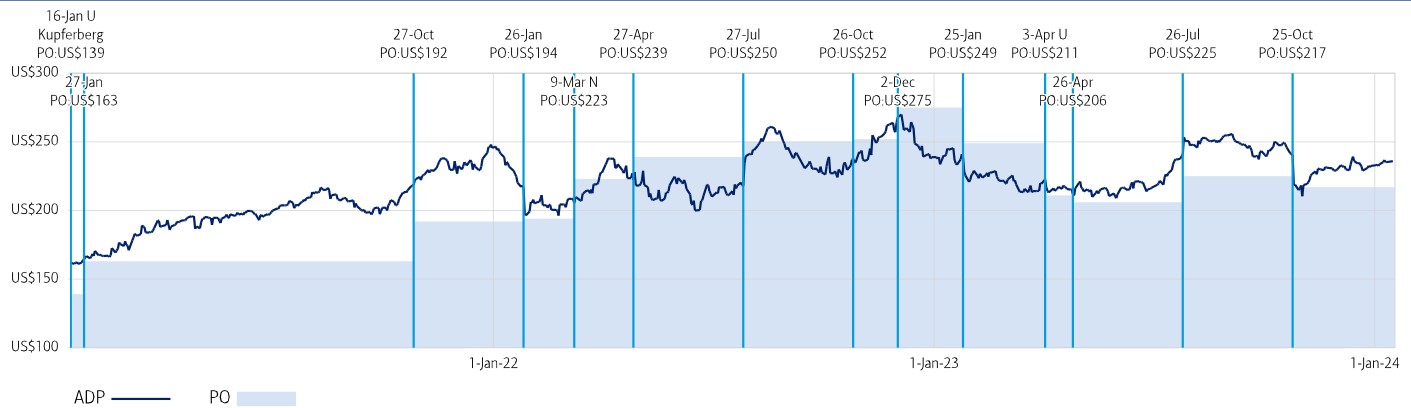
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Automatic Data (ADP) Price Chart



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 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{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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