



Automatic Data Processing (ADP)

Updated August 10th, 2024, by Josh Arnold

Key Metrics

Current Price:	\$262	5 Year CAGR Estimate:	13.0%	Market Cap:	\$107 B
Fair Value Price:	\$290	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	09/13/24
% Fair Value:	90%	5 Year Valuation Multiple Estimate:	2.1%	Dividend Payment Date:	10/01/24
Dividend Yield:	2.1%	5 Year Price Target	\$446	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 \$107 billion, producing annual revenue of about \$20 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 fourth quarter and full-year earnings on July 31st, 2024, and results were better than expected on both the top and bottom lines. Adjusted earnings-per-share came to \$2.09, which was three cents ahead of estimates. Revenue for the quarter was up 6.5% year-over-year to \$4.77 billion, beating expectations by \$30 million.

Employe Services revenue was \$3.22 billion, up 7% year-over-year. Segment earnings were up 14% to \$1.06 billion, a margin of 33% of revenue. That was up 220 basis points from the same period a year ago.

PEO Services revenue was up 6% to \$1.55 billion, but earnings declined 10% to \$208 million. Segment margin declined from 15.8% of revenue to 13.4%.

Adjusted EBIT was \$1.11 billion, up 10% year-over-year. Adjusted EBIT margin was 23.3% of revenue, and 80 basis point improvement from last year's Q4.

We initiate estimates at \$10 per share for 2025 based upon initial guidance from management.

Growth on a Per-Share Basis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
EPS	\$2.89	\$3.25	\$3.70	\$4.53	\$5.45	\$5.92	\$6.02	\$7.01	\$8.23	\$9.18	\$10.00	\$15.39
DPS	\$1.95	\$2.08	\$2.24	\$2.50	\$3.06	\$3.52	\$3.70	\$4.05	\$4.79	\$5.45	\$5.60	\$8.23
Shares¹	466	456	445	439	436	429	424	416	412	408	404	390

Automatic Data Processing has compounded its adjusted earnings-per-share at a rate of more than 13% 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. Looking forward, 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

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Valuation Analysis

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Now	2030
Avg. P/E	24.5	29.0	26.0	27.0	27.1	26.8	27.7	29.1	26.7	26.0	26.2	29.0
Avg. Yld.	2.5%	2.3%	2.5%	2.3%	2.1%	2.2%	2.2%	2.0%	2.2%	2.3%	2.1%	1.8%

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 26.2 times this year's earnings-per-share estimate, which compares quite favorably to our fair value estimate at 29 times earnings. That implies a modest tailwind to total returns in the coming years from valuation expansion. We see the yield remaining around 2% in five years, in part thanks to strong forecasted dividend growth, partly offset by a higher valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030
Payout	68%	64%	61%	55%	56%	59%	61%	58%	58%	59%	56%	54%

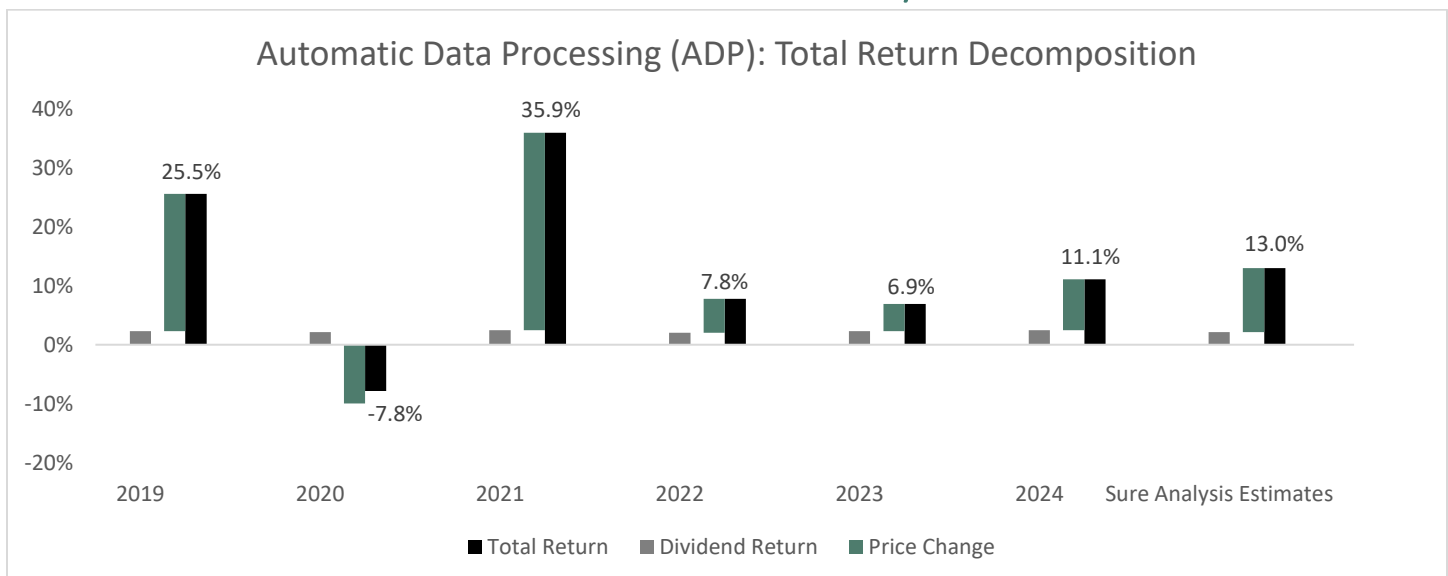
What immediately stands out about ADP's quality metrics is the high levels of debt. Fortunately, the vast majority of this debt is in the form of client fund obligations – money that is held by ADP before being paid out to the employees of its corporate customers. These client fund obligations are actually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

ADP continues to deliver and guide for sustained growth over time. With 13% total projected returns, we're reiterating the stock at a buy rating after fiscal 2024 results. This stems from 9% earnings growth, a 2.1% dividend yield, and a 2.1% tailwind from the valuation. Given ADP is likely to become a Dividend King this year, it is all the more attractive.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Revenue	10,939	11,668	12,372	13,328	14,175	14,590	15,005	16,047	17,199	19,203
Gross Profit	4,511	4,828	5,128	5,517	6,089	6,145	6,365	6,585	7,245	8,726
Gross Margin	41.2%	41.4%	41.4%	41.4%	43.0%	42.1%	42.4%	41.0%	42.1%	45.4%
SG&A Exp.	2,497	2,637	2,774	2,959	3,064	3,003	3,041	3,233	3,551	3,745
D&A Exp.	278	289	316	378	409	480	511	515	549	562
Operating Profit	2,014	2,191	2,354	2,557	3,024	3,142	3,325	3,351	3,694	4,981
Operating Margin	18.4%	18.8%	19.0%	19.2%	21.3%	21.5%	22.2%	20.9%	21.5%	25.9%
Net Profit	1,453	1,493	1,788	1,885	2,293	2,467	2,599	2,949	3,412	3,752
Net Margin	13.3%	12.8%	14.5%	14.1%	16.2%	16.9%	17.3%	18.4%	19.8%	19.5%
Free Cash Flow	1,639	1,511	1,655	2,044	2,122	2,410	2,587	2,546	3,636	3,594
Income Tax	694	741	829	398	713	716	763	855	1,026	1,120

Balance Sheet Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total Assets	33,111	43,670	37,180	38,849	41,888	39,166	48,773	63,068	50,971	54,363
Cash & Equivalents	1,639	3,191	2,780	2,170	1,949	1,909	2,575	1,436	2,084	2,913
Acc. Receivable	1,547	1,743	1,704	1,984	2,439	2,441	2,727	3,171	3,010	3,428
Goodwill & Int.	2,297	2,216	2,361	3,130	3,395	3,525	3,549	3,634	3,683	3,690
Total Liabilities	28,302	39,188	33,203	34,113	36,488	33,413	43,102	59,843	47,462	49,815
Accounts Payable	195	152	150	135	126	102	141	110	97	101
Long-Term Debt	9	2,008	2,002	2,002	2,002	2,005	2,985	3,124	2,989	3,377
Total Equity	4,809	4,482	3,977	4,736	5,400	5,752	5,670	3,225	3,509	4,548
LTD/E Ratio	0.00	0.45	0.50	0.42	0.37	0.35	0.53	0.97	0.85	0.74

Profitability & Per Share Metrics

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Return on Assets	4.5%	3.9%	4.4%	5.0%	5.7%	6.1%	5.9%	5.3%	6.0%	7.1%
Return on Equity	25.3%	32.1%	42.3%	43.3%	45.2%	44.2%	45.5%	66.3%	101%	93.1%
ROIC	21.2%	26.4%	28.7%	29.6%	32.4%	32.5%	31.7%	39.2%	53.7%	51.7%
Shares Out.	466	456	445	439	436	429	424	421	416	412
Revenue/Share	22.99	25.41	27.48	30.06	32.39	33.72	35.05	38.11	41.37	46.59
FCF/Share	3.44	3.29	3.68	4.61	4.85	5.57	6.04	6.05	8.75	8.72

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

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