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ADP - Q1 2018 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

Co. reported 1Q18 revenues of $3.1b and adjusted diluted EPS of $0.91. Expects FY18 revenues to grow 6-8% and adjusted diluted EPS to grow 5-7%.

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PRESENTATION

Operator

Good morning. My name is Brian, and I will be your conference operator. At this time, I would like to welcome to everyone to ADP's First Quarter Fiscal 2018 Earnings Call. I would like inform you that this conference is being recorded. (Operator Instructions) Thank you. I will now turn the conference over to Christian Greyenbuhl, Vice President, Investor Relations. Please go ahead.

Christian Greyenbuhl - *Automatic Data Processing, Inc. - VP of IR*

Thank you, Brian, and good morning, everyone. This is Christian Greyenbuhl, ADP's Vice President of Investor Relations, and I'm here today with Carlos Rodriguez, ADP's President and Chief Executive Officer; and Jan Siegmund, ADP's Chief Financial Officer. Thank you for joining us for our first quarter fiscal 2018 earnings call and webcast. During our call today, we will reference certain non-GAAP financial measures, which we believe to be useful to investors. A reconciliation of these non-GAAP financial measures to their comparable GAAP measures is included in our earnings release and in the supplemental slides on our Investor Relations website. I also wanted to highlight for you that the quarterly survey of revenue and pretax earnings for our reportable segments is also available on the Investor Relations section of our website. These schedules have been updated to include the first quarter of fiscal 2018. Before Carlos begins, I'd like to remind everyone that today's call contain forward-looking statements that refer to future events, and as such, involves some risks. We encourage you to review our filings with the SEC for additional information on risk factors that could cause actual results to differ materially from our current expectations.

Now let me turn the call over to Carlos.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Thank you, Christian, and thank you for joining our call this morning. We appreciate your interest in ADP. This morning, we reported our first quarter fiscal 2018 results, with reported and organic revenue up 6% to $3.1 billion. We're pleased with this revenue growth which is above our expectations. Revenue growth in the quarter includes approximately 1 percentage point of pressure in the fiscal 2017 disposition of our CHSA and COBRA businesses, which were substantially offset by the benefits from foreign currency. Our adjusted diluted earnings per share grew 6% to $0.91 per share and benefited from a lower effective tax rate and fewer shares outstanding. Overall, this earnings growth in the quarter exceeded our expectations, and we're very pleased with our solid results, which Jan will walk through in more detail shortly.

New business bookings during the first quarter were down 3% compared to the first quarter of 2017. This performance was in line with our expectations as we begin to realize the benefits of our fiscal 2017 headcount investments while we continue to manage through the effects of the regulatory uncertainty that has prevailed since last year's U.S. elections.

Despite the short-term bookings pressure, we continue to be very pleased with the performance of our downmarket businesses and the solid results in our multinational business.

As we communicated previously, we continue to expect our bookings growth to gradually expand back to pre-ACA growth levels as we progressed through the year. As a result, we continue to anticipate full year fiscal 2018 new business bookings growth of 5% to 7%. On a client retention front, we experienced a 160 basis point improvement during the quarter, which was ahead of our expectations and saw positive growth across all of Employer Services markets. This performance is due in part to our continued efforts to upgrade clients to strategic cloud platforms as well as the investments we've made to improve the client service experience while also aided by the easier compare from our fiscal 2017 first quarter federal government OPM contract loss.

Our client upgrade initiatives continued to progress nicely, and now we have more than 83% of our clients on our strategic solutions. We also continue to make good progress on din our Service Alignment Initiative, where we now have 2,000 Associates across our 3 new scalable service centers and 5,400 associates in total across all 5 of our strategic service locations, delivering service to clients across the HCM spectrum. I'm proud of these efforts and of our speed to execute, which have enabled us to rationalize our footprint by exiting 9 subscale facilities this quarter. This represents a closure of 63% of our total planned exits under this initiative in just over 1 year.

The progress we are making with respect to new platforms and improved service is leading to happier clients and improvement in our MPS course. It isn't just our own internal metrics that is helping us tell the story. Last month, G2 Crowd, a leading software review platform, ranked our Workforce Now solution #1 in satisfaction for payroll and HR management suites in their fall midmarket grid report. In analyzing the reviews of actual users of the product, ADP was also named the leader in all 5 HR software categories: payroll, HR management suites, core HR, performance management and applicant tracking systems. We are excited about the divisions we continue to introduce to the markets that are helping clients meet the dynamic needs of an evolving workforce. And it's gratifying to see these investments in HCM innovation continue to be recognized with prominence in the industry.

A few weeks ago, I had the opportunity to attend the HR technology conference in Las Vegas, where few of these innovations took center stage. For the third consecutive year at HR Tech, ADP was recognized with the HR product of the year award from Human Resources Executive magazine. This time, for our Encompass solution, which is designed to boost a leadership and collaboration behavior of our clients' employees. In addition to this recognition, we scored a second 3-peat at the show after our paid equity explore solution was named one of HR executives awesome new technologies. The equity explorers a powerful tool that combines data science and benchmarking and is built in the biggest data set in HCM, the ADP data cloud. It was developed to help clients uncover insights and identify potential opportunities when it comes to gender or raise pay gaps, so they can stay competitive in a war for talent. Innovation is a job that's never done. While we are incredibly excited about the solution we are delivering in the market today, we are even more excited about the future. In September, we had the opportunity to brief HCM industry analysts on the new products and services coming out of our global product and technology organization. At the event, we previewed our next generation of client centered innovation, including a low code application developer and platform that enables internal and external development teams to build agile country, segment and client specific applications, leveraging the latest technology and delivered by the public cloud.

We also shared progress in our efforts to deliver next-gen payroll and tax filing engines which will further increase our differentiation and payroll and payments. These engines are designed to promote the country localization and will enable us to deliver pay and other services with greater flexibility based not only in the needs of our clients today but also their evolving future needs as organizations are increasingly comprised of both full-time and contract workers.

ADP's unique ability to meet the needs of our clients today while anticipating their needs in the future have been hallmarks of our success over the past 68 years, and will drive our sustained growth in the years ahead.

Also before I turn the call over to Jan, I'd like to say a few words on our acquisition of Global Cash Card, which we announced in October. As the core of HCM is ensuring employees are paid accurately, securely and in a timely fashion. This is the DNA of ADP. And with the acquisition of Global Cash Card, we are strengthening and expanding this core capability. For those not familiar, Global Cash Card is a leader in digital payments, including pay cards and other electronic accounts. The digital payment space is an exciting one for the future of payroll. The increasing use of contract workers in t he gig economy has driven the demand accounts, which could lead independent contractors being the various wages and expenses into a single account, providing the best picture of the their financial well-being. From the employer's perspective, digital payments can be less expensive, more immediate and a more secure option than other means of payment such as paper checks. With this acquisition, ADP becomes the only HCM provider with a proprietary digital payments processing platform, which will be integrated with our align pay card solutions for our seamless client experience.

We are excited about this acquisition, we're pleased to welcome the global cash card team that a ADP family.

I'm proud of the efforts of our associates. Our results in a quarter continue to reflect enduring qualities of ADP, including a culture that is relentlessly focused on delivering a great client experience through best-in-class technology and unparalleled service.

Fiscal 2018 is off to a good start, and we look forward to turning over full attention to advancing our strategy and delivering on our commitments to all stakeholders. Clients, shareholders and associates alike. And with that, I'll turn the call over to Jan for a further review of our first quarter

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Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

Thank you very much, Carlos, and good morning, everyone. In my commentary to follow, I will be referencing non-GAAP measures that exclude the impact of certain items in the first fiscal quarter of 2018 as well as a first quarter fiscal 2017 restructuring charge of about $40 million related to our Service Alignment Initiative. A description of these charges and a reconciliation of these non-GAAP measures can be found in this morning's press release and in the supplemental slides on our Investor Relations website.

As Carlos mentioned, ADP revenues grew 6% in the quarter to $3.1 billion on a reported and organic basis. On a reported basis, net earnings grew 9% or 8% on a constant dollar basis. Adjusted earnings before interest and taxes or adjusted EBIT, declined 3% on a reported and constant dollar basis. Adjusted EBIT margin decreased by about 150 basis points compared to 19.8% in last year's first quarter. This decrease was slightly better than our expectations despite additional pressure from growth in our pass-through revenues and a very difficult first quarter fiscal year 2017 compare when we expanded margins by 230 basis points.

As a reminder, this first strong -- this strong first quarter fiscal year 2017 margin performance was driven by incremental ACA-related revenues, together with operating efficiencies and lower selling expenses, which now have lapped. During the quarter, we continued our planned investments into innovation, service and distribution while we worked through the short-term pressure from the anticipated lower revenue growth in the first half of fiscal year 2018. As we managed for the pace of our transformation efforts to upgrade our clients and to transform our service experience, we believe these investments will continue to help us deliver against our long-term financial strategic objectives.

Adjusted diluted earnings per share grew 6% to $0.91 and 6% on a constant dollar basis have benefited from lower effective tax rate and fewer shares outstanding compared with the year-ago. Our adjusted effective tax rate was positively impacted by unplanned stock compensation tax benefits, which accounted for approximately 90 basis points of the overall decline in our adjustment effective tax rate for the quarter or $0.05 cents to our adjusted diluted earnings per share.

As Carlos mentioned, our new business bookings were down 3% and in line with our expectations for the quarter as we begin to re-accelerate our bookings growth and overcome the remaining additional sales of Affordable Care Act-related modules in the first half of fiscal year 2017. Overall, I'm pleased with our results for the quarter (inaudible) off to a positive start we're making good proxies as we execute against our strategic initiatives.

Now let me take you through our segment results before moving on to our fiscal year 2018 outlook. In our Employer Services segments, revenues grew 2% for the quarter and 3% on an organic basis. Our same-store pays per control metric in the U.S. grew 2.4% in the quarter. Average client funds balances was 6% compared to a year ago, 5% on a constant dollar basis. This was driven by additions of net new business and increased wage levels compared to the prior first year's quarter.

Outside the U.S., we continue to see solid performance from our international operations with double-digit revenue growth in our multinational businesses. Employer Services margin decreased about 110 basis points in the quarter. This decrease was driven by continued investments into our operations, innovations and distribution. The PEO continues to perform well growing revenues 14% in the quarter with average worksite employee growing nicely by 10% to 484,000 employees. This revenue growth was primarily driven by the growth in average worksite employees and accelerated growth in health care renewal premiums. This accelerated growth and passed through help their premiums was also the primary driver for the 60 basis points decline in PEO margins this quarter. But its impact is expected to abate as the year progresses. And I'm pleased with the performance of both of our segments in this quarter. And as Carlos mentioned, we are off to a good start. Before I discuss our fiscal year 2018 outlook, I wanted to highlight some additional detail regarding the acquisition of Global Cash Card. The results of operations of this business will be included in the employers services segment, and I expect it to contribute just under 1 percentage point of growth in our updated revenue guidance. While we anticipate future synergies, we also anticipate some slight pressure to margins this year, largely driven by integration costs. Accordingly, we have factors operationally back into our updated fiscal year 2018 outlook.

As a reminder, fiscal year 2018 has a mix of factors impacting revenue growth and margin in the first half of the year, including the disposal of our CHSA and COBRA businesses in November of fiscal year 2017, the impacts to revenue and margin from the incremental ACA-related revenues during the first half of fiscal year 2017, which now have been fully lapped; and also the impact to revenue growth in fiscal year 2018 from lower retention and lower-than-anticipated new business bookings in fiscal year 2017. With these items in mind, I will now take a moment to walk through our revised outlook with you. First, as Carlos mentioned earlier, we are reaffirming our full year new business bookings guidance of 5% to 7% growth on the $1.65 billion sold in fiscal year 2017. With the acquisition of Global Cash Card and some adjustments to our anticipated impacts from our foreign currency translation, we have updated our consolidated revenue forecast growth from 6% to 8% compared to our prior forecast of 5% to 6%. And employee services revenue growth of 4% to 5% compared to our prior forecast up 2% to 3%. Separately, we are reaffirming our PEO revenue guidance of 11% to 13%.

We are also now expecting growth in interest revenue to increase $45 million to $55 million compared with our prior forecasted increase of $40 million to $50 million. The total impact from the client funds extended investment strategy is now expected to be up $35 million to $45 million compared to the prior forecast increase of $38 million to $40 million. The details of this forecast can be found in the supplemental slides on our Investor Relations website.

Our margin forecast remains unchanged. We continue to anticipate our consolidated adjusted EBIT margin to contract 25 to 50 basis points from 19.8% in fiscal year 2017. And at the segment level, we continue to anticipate margin contraction in certain employee services of 50 to 75 basis points, with PEO margins expected to expand 25 to 50 basis points.

We now expect growth in adjusted diluted earnings per share of 5% to 7% compared to our prior forecast of 2% to 4%, aided by about 1 percentage points from the first quarter stock compensation-related tax benefit. Having fully returned the proceeds of our debt offering to shareholders in 2017, this forecast does not contemplate any further share buybacks beyond the anticipated dilution related to equity compensation plans. However, it remains our intent to return excess cash to shareholders, subject to market conditions. So with that, I will turn it over to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from the line of Tien-tsin Huang with JPMorgan.

Tien-tsin Huang - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Just I guess on the retention front. I'm curious where you're seeing the greatest improvement there. Is it more in the midmarket as you convert to strategic cloud platforms? Any color across the organization?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I think as I mentioned in my comments, I think this quarter, the improvements were really across all of our ES segments. And as we said in the past many times, retention can be very volatile metric especially as you get into the upmarket. But we had -- this quarter, we happen to have good news and we're very happy about it. We think that is not just because of volatility but I think because some of the things we've been doing around investments in our service we see our impious scores coming up. And so we're very pleased with that. I would say that to your question about the midmarket, we are not finished yet with the migrations of our clients in the midmarket. We have about 2,000 left. We still think that will be close to done, if not done, by the end of the calendar year. We might have a couple of stragglers. But we do expect to be substantially done by the end of the year. And that does put pressure on our retention because times and is still holds true that there's quite a substantial difference in retention between our strategic platform in midmarket and our legacy platform. So I think what you're alluding to, we hope and we expect will happen a couple of quarters from now as all these migrations market behind us. but that cannot be one of the reasons why there was improvement in the midmarket as well as interest of ES this quarter.

Tien-tsin Huang - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Right.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

One additional comment. Don't forget that we had a little bit of an easier growth over this quarter. We lapped the lost of a large client that we talked about last first quarter and in the year. So the improvement was, in particular, visible in enterprise space by partially aided by the lapping of that 5 bus.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I think the impact of large losses was around 100 basis points last year. So the right way to look at this is about 60 basis point improvement and retention is for the quarter?

Tien-tsin Huang - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Right. You get that back but still a little bit better. Okay, good, good, good. Just my quick follow up just on PEO. Was it a unit growth of 10%. I think that's a little bit below trend. Anything to read into there in PEO?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Other than that it's getting really big. We're still pretty happy with 10% unit growth. And I don't think anything further to report there but that's becoming a very large -- were close the 0.5 million worksite employees if you look at it, which we do as an employer even though there are subclients obviously there's 1 in 10,000 clients in the PEO. But it's a very large way we treated the way we have our retirement program and the way we have workers' compensation and benefits, et cetera. We are a co-employer and we consider it sounds employer for the purposes of some of the responsibilities around employment. And so technically, I think we're probably in the top 5 now in terms of the size of employers based in the U.S. business. We're just becoming a very large base. But we feel pretty gabby and pretty satisfied with that kind of growth rate.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

The development is right in line with our expectations, and as you saw we are reaffirming our revenue guidance. So doing good.

Operator

Our next question will come from the line of Jason Kupferberg with Bank of America Merrill Lynch.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

I just wanted to follow up on the comments around migrations. I think you said 83% of clients have now been migrated to the next-gen platforms. Can you tell us in terms of percentage of revenue where we stand on that? And then any comments around a reasonable new bookings growth range for Q2.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

So just to make sure we get our language clear here because we have been introduced some new terminologies and what we refer to next gen platforms. So we have our strategic platforms, which are Workforce Now run Vantage and our global you will to national. We did start talking and he mentioned it in our introductory comments that we talked the industry analysts in mid-September next-generation platforms which we have only a handful of clients on today. So I just want to make sure I clarified kind of the language there. As we go forward, we'll be more careful about making sure that we pick the right language. So I'm sorry, the rest of the -- what was the rest of the question?

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

The percentage of revenue then I guess that has migrated to this strategic platforms I think you said 83% of clients but percentage revenue.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

So since we still have a lot of work to in the upmarket where we really only begun the migrations and consistent with what we've said. Before, in our publicly released information around the proxy cards, I think we included their about 51% of our revenues being on our strategic platforms that I just mentioned the names of. It's very important to note that when we talk about our strategic platforms, we have a number of areas of our business where there's really no immediate plan to migrate or move clients. So for example, our insurance services, our retirement services. We have international platforms that we're happy not planning any movement there. So we're probably in the future, be able to provide some more color around the addressable market. In other words, what part of our client base is really up for migration, if you will, but the right answer, the straight answer is 51%. But we're not getting into 100%.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

And then Jason, if I pick up your question regarding the second quarter, is we're reaffirming just our full year guidance for 5% to 7%, and we don't give quarterly guidance, really, for our new business bookings or any other number. And before Carlos, the 51% of the revenues refers to ES revenues. That's all the metric that we can offer.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

Okay. And it's good to hear about some of the innovation investments that you're doing. Any detail we can get on latest trends with respect to your overall R&D spending, the budgets they are instead of kind of the maintenance piece for some of the legacy platforms and how much of the R&D budget has been directed to new product development and any shifts in those ratios?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Sure. We disclose a lot of information again as we're trying to communicate with shareholders about some of the things that we've been doing over the last 5 or 6 years. We've disclosed, I think, some additional information about that. And I think starting off and the fact that we've increased our innovations spend from around $150 million to around $450 million, or somewhere thereabouts, in that neighborhood. So a significant amount of increase in our R&D investments, up a large part of that was the next generation platforms that we just announced recently that we've been working on here some cases for 3 to 4 years. But we've also made big investments in things like our data cloud and things like our mobile solutions and some of the other products and innovations that we actually already have out in the market and are helping us, I think, with our efforts in helping our clients and helping drive new business bookings, retention and so forth. So that's a sense of what's happened with the innovation spend. On the maintenance spend, for the sake of, I guess, government work it's about flat. So it increased slightly. But again, in the world of some inflation, the fact that we've held that constant, we see that as a good news story. It was a conscious effort to really shift the mix, if you will, the balance of our spending to more innovation and less maintenance. A lot of our maintenance spend is focused on platforms that served tens of millions of employees that get paid, both on our tax engine and our payroll engine. And so as we develop these next generation technologies, when we retire those legacy platforms, which is a ways down the road, then obviously, there'll be -- we would expect actual decreases in maintenance spend. But for the last several years, it's really been a story of increasing the spend and making sure that, that spend is focused on innovation while we build out the necessary platforms to move clients to and then reduce the spending on those legacy platforms. We ever return, I think it's around 13 legacy platforms. So it's the first time in a long time at ADP that we actually retried things. It's not like we haven't made any progress but wait relatively small dollar items in terms of the overall maintenance spend, really big chunks of spend are some of the large scaled legacy platforms that service, by the way, very well and very efficient, very secure and very reliable. And we have no plans to get off of them in the next 3 to 6 months or any timeframe like that. So this is a -- as you always say, this is an evolutionary process, not an overnight change.

Operator

Our next question will come from the line of Mark Marcon with Robert W. Baird.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Two questions. One, any sort of impact at all with regards to all the hurricanes in terms of sales cadence, implementations? Anything along those lines. That's the first question. Second question is basically on the PEO and pass through growth rate. When we think about long-term, would you expect this pass through growth rate to be kind of in this 14% range if we have underlying say PEO growth in the 10% or how should we think about that from a longer-term perspective? And then lastly, can you just comment with regards to all the distractions that has been going on is in terms of how it's impacting to focus out in the field and operations.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

So I'm going to let Jan maybe go through a few of the numbers here. But let me just quickly on hurricanes and Jan will give you a sense of impact. Clearly, it had an impact of the business. But I just want to take a moment to also point out that these were massive storms, especially in Houston and in Puerto Rico. We have a decent sized business in Puerto Rico. We also have a very large presence in Texas and in Houston specifically and what our associates and our infrastructure people did to be able to continue our business not necessarily as usual but to make sure the business move forward and that we served our clients with nothing short of heroic, including flying airplanes from Tampa when no other planes are flying. Puerto Rico to deliver supplies our associates but also deliver payroll for the businesses still functioning and still willing to pay tax we have money and obviously was an incredible prices. So the fact that you're asking the question, I think shows the strength of ADP that we continue to perform and to deliver based on very, very challenging situation. I think Jan maybe had a little bit of color on the numbers.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

Yes. We experienced some impact on our risk bookings in the quarter and October could have some clean over but you can see from our reaffirming of our year guidance bookings we had strong performance that overcame that in the quarter. It was performed according to expectations. But there is an impact on our sales force and there could be an impact on our revenues and losses to be quite honest as Puerto Rico is recovering. It will not be material or meaningful to our overall full year performance. But we're sorting that out. So the business and our clients in Puerto Rico recovering, and we're working with those clients. That all of them are back online yet. But a large number has and there could be some second quarter impact. But it's not really that material that should impact your calculations. In the long, I think, we expect this to be just back to business a little bit of possibility recovery and in fact we sometimes experience in the longer sense of a year to 18 months out. But I would assume the workers else through it throughout the year. or dear pass-through revenues, to 14% is a little bit on the high side. It has the variety of reasons. As you recall in the first half of last year, we experienced this meaningful margin expansion at the POA and overall for the ADP, as we illustrated then, by lower than typical pass through revenue growth. And for the factors that impact all pass through revenue growth a multitude of things have all played in the last couple of years. The first thing is the participation rate in our PEO and throughout the introduction of the AZA in last year, we have seen an increase in employee participation and our PEO. That now has stabilized.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

And health benefits because rate has now stabilized. So we have seen now year-over-year relative stable employee participation rate. With incomes as the overall renewal rates, which we now experience health care inflation is a we described. It's obviously dependent on the overall market development of medical health inflation. And the last component is the actual employee choice of plants of where we have seen a general trend to higher deductible consumer health-oriented plans. But there's a little bit of an anomaly in the quarter, employees acted out of the most skinny solution and diverted a little bit into a higher quality medical plans and their client base, which is a little unusual because overall positive growth perspective that have been percent on the high side I would say in our long-term plans, we anticipated and we publish on our investor day pass through growth from prostate 12% to 14% Mac.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Just to point out, there been time today so we end up PEO was even higher than this. So us Jan said, even depends on the general health care inflation environment. It's clearly not sustainable from so much about her PEO in our own company. But this is why there was health care reform to begin with. You can have this kind of health care inflation for a long period of time because it just doesn't work from an economy standpoint. And because entire eventually. So it's safe to say that this is a number that has to, by definition, maybe not over a quarter or 2 or 1 year, that number has to, at some point, converge or regress back to the mean. But we have had times where we had even bigger differential for worksite employee growth and our pass through revenue growth. And this is probably from a 3- or 4-year standpoint by the highest and it's been. Is probably in line with what you're hearing out in the world, right? Which is health care inflation is picking up a little bit.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I was just trying to get the longer-term with not so subtle reference to some of the discussion around okay, well, how much pass through -- when we think about the net operating profit margin growth that we're going to end up having, how much of an impact is the pass-throughs going to be and what's the right growth rate to factor in.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Yes. We'll try to help with that. We encourage people to do look at services and margins and profit growth and the PEO's margin and profit growth. We're focus on growing EPS in creating value for our shareholders. When that fixated on the specific margin number of the revised November important to the overall economic model, and to actually building a model that works.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

At the end of the day, it's return on invested capital, right?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Right. I mean, that's ultimately the -- growth in Employer Services and profitability Employee Services and growth in PEO will ultimately drive returns on invested capital and that's really the right way to focus on the business. As you know, our PEO business is our most profitable, most successful mass business. So for us to get overly concerned about mix and what impact that has on the overall margin, I realized that's something that we have to address and we have to talk about an help people with their models. But it's really not the right way to focus in the business. So you did mention about that distraction is my answer that question because others may have the same investors asset at the same thing is a lot of concern about the disruption of the proxy card. I would say that it's a extremely high distraction for actually small group of people. As you can see, from the Gulf this quarter, it did not distract our associates or our sales force.

Operator

Our next question will come from the line of Rick Elkins with Wells Fargo.

Richard Mottishaw Eskelsen - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

I just wanted to follow up quickly on tangents follow question on the PEO. You did say the PEO ending client works in employee's down slightly sequentially. That's out of the ordinary for that business. I'm just curious if there's anything kind of onetime going on and anything pulled forward last quarter. Maybe just a little bit more color on the PEO. That will be helpful.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

I think I wouldn't enter bit leave it a little bit of fluctuation and now sales coming in how the last quarter ended in they're like kind of different growth dynamics. So I noticed in myself that there's nothing out of the ordinary here that I could report.

Richard Mottishaw Eskelsen - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

That's helpful. Just a quick follow-up. You talked about the pay equity tool in the data cloud. Just wondering if the tell us more on what you guys are doing on big data. I know that's bit of us are long-term team on this at more details on the big data and analytics progress will be helpful.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

Yes. Saucepan if you know, we believe that it's going to be one of our a long-term strategic differentiators or is already today actually. We're selling our core product of data analytics, benchmark to our core client based and to new clients, we just data cloud delivers no more than 30 benchmarks. Let's go reporting and on top of that, you would have the platform we are released a numerous incremental value-added solution that you see in our emerging strategy. So the first tool that we have been working on is a tool that allows our employers to manage the risk of employee retention and employee loss and can predict the likelihood of employees leaving the company and allow companies to way better manage their performance and over outcomes, we now released incremental tools on the pay equity store, which is a compliance tool which helps to identify potential misalignment and your compensation relative to diversity measures. And the richness of the tool as kind of the exciting part because it will go in a variety of areas towards verticals, towards specific problems to be addressed. And you're going to see a continued innovation coming out and all being fully integrated into our cloud-based platform, which is the benefit that we are now repaying from having one data cloud tool strategic platforms and then the relative ease of integration of this insights and data analytics into the actual platform. So it's going to be a very important tool in this innovation on explore the specific was that Carlos mentioned really driving the differentiation, leading and trying discussions of helping us increase hourly rates. So it's really exciting and there's also revenue caring. That's been a question around that they would charge for this tool and we do charge for data cloud. We do charge for data cloud. The current revenue model that client buy

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Operator

(Operator Instructions) Our next question will come from the line of James Berkley with Barclays.

Unidentified Analyst

Looks like your top line guidance ticked up about 20 basis points, the high end of the range. There was an incremental 100 expected improvements coming from global cash and FX combined. Is that just a function of rounding or trespassing your prior expectations?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I think it's probably -- it's both. We obviously better about what's going on with attention. I think the trends in the business, we had a little bit of help even from floating income as I mentioned because that actually flows into our top line as well as into our bottom line. But I think you're correct that just happen to be the way the numbers fall out as well. So I think it's both things.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

It's Global Cash Card FX and then a tiny bit of pass-through is in our exit guidance also. So that may be the third factor if you look forward factor's B-17 all right. And I just want a quick follow-up. You guys always related double margins over a 6-year period. Them in markets all Reynolds wrap up here. Could you just talk about classifications are margin expansion over like say, like another 6-year period for the midmarket and then your thoughts on the upmarket long-term as well?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Sure. I think that one of the things that we've been kind of going out talking to folks, making sure that opportunity that makes everyone understand that the starting point for margins in terms of the amount of room there is improvement for larger than the small business market than it is in the midmarket. So we have a successful good business in the midmarket, including healthy margins. We do think that based on what we see around retention potential because the real important small business division was the rise in retention, which is a fairly big thing on impacts in that business on margins because them out of business you have the cell, which brings with the sales caused and beauty cost is less to achieve the same growth objective, if you will. and so that was an important part of that picture, if you will, small business. Improving the retention. I was hopeful, based on what we're seeing so far, that we are going to experience that improvements and retention in our midmarket as well was we have -- were through migrations all for clients in 1 platform. Better retention which an avid same impact SBS with us the says that you have the less business in order to achieve the same growth rate or you can grow faster like either they get the best of both worlds that you could choose which way depending on market conditions want to move. But the absolute starting point is important as it is always in any situation. And again, we don't give specifics of segment data if you will. Neither do any of our competitors I would just point out. But the fact that the margins are higher. They were higher to begin with an midmarket. in the re-platforming is really about strengthening our competitive position, driving faster growth and hopefully, some modest improvement in margins as well because we do expect to get higher retention rates in the mid- to long-term as you get all of our clients into 1 platform.

Operator

Our next question will come from the line of Jim Schneider with Goldman Sachs.

James Edward Schneider - *Goldman Sachs Group Inc., Research Division - VP*

Was maybe wanted to ask a follow-up question on the margin side of things. Can you maybe just give us an update short-term in terms of your investment programs on any other new products and how that's kind of contributing to the margin degradation in the next couple of quarters. And then as we exit the year and head into 2019, is it reasonable to expect that you would, as a kind of get to the compounded 50 to 75 bps of long-term margin expansion you've guided to whether we see kind of above normalized margin expansion in the back half of this year and heading into 2019?

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

Yes, Jim. This year, we have about similar amount of dual operations cost. I think it's about 20 to 25 basis points of margin pressure for the company in the fiscal year. And as complete all service alignment and then Carlos mentioned, we're making good progress on that. We've exited 9 locations already in this fiscal year and we are on track on and on time we see that those new associates is going to be settling in and dual ops is going to disappear and the next year, in fiscal year '19 and '20, we did actually provide and investors an idea about the margin expansion characterized to be around 100 basis points at the enterprise level and our presentations, there's nothing changed in our view that we would be doing at this point in time. So that would -- the dual ops would be dissipating and then I think also elsewhere in the presentation, with alluded to the fact that we see the benefit of workflow efficiency wage advantages and so forth that our strategic divisions offer and contributing incremental to the productivity improvements and cost efficiencies. So I think what we're presenting is kind of the current plan.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I think I also want to point out again. I want to say one more time that clearly some of the pressure we're experiencing is from investments that we have been investing in our sales force for example. But it's just important to note that some of what's happening in these numbers this mathematical grow versus and comparisons because last year, in the first half of the fiscal year, so the last 2 quarters of the calendar year, we had almost 20% operating income growth. And then in the last 2 quarters of the fiscal year, first 2 quarters of the calendar year. Because of the ACA growth and the comparisons of having lapped the revenues, the revenue comparison, we ended up having the numbers going opposite direction at 2 quarters we're in right now. Quarter that we're just reporting across the next quarter or really mirror images of the first 2 quarters of the calendar year. And then as we've said multiple times in our guidance, our second half of this fiscal year gets back from a margin standpoint, from a growth standpoint, from a bookings standpoint to a more reasonable normalized place, if you will. So unfortunately, the way you guys notice then better than anyone else. Whatever acquisition and there were some other factor, you have to really beyond that and understand what's really happening beneath that covers. And so we had 12 months of easy comparisons. And then we had 12 months of hard comparisons. We now have, I guess right now, couple of more months before we get to those difficult comparisons.

James Edward Schneider - *Goldman Sachs Group Inc., Research Division - VP*

That's helpful context. And just follow-up on the product side. Maybe for carless. As you think about your enterprise broad suite in how you plan to refresh and augment it over time because we're from the local lug development platform. And maybe give us a sense about your conversations with clients in the early stages. What are the elements of this platform that are resonating with them. And do you get a sense of any of the enterprises that may be shopping around or 3 were potentially have changed their mind about switching off a fund platform or staying at an OneADP platform because of this. We hope, we do, for example, invite clients in a regular basis to visit our innovation center in New York City and Chelsea to kind of get first hand knowledge of some of the things that we're working on. And it's not just about the platform. We have other things we're working on us well that we share with our clients. So obviously, part of that is an effort to make sure understand our road map and so today stick with us as we get through product development and then eventually a transition to our New York platform did either business segments will obviously be very important in the upmarket enterprise space where the client leg cycles are very, very low. We have very high retention rates and our upmarket business, clients day, 15 to 20 years on average. And I was they, as you're staying with ADP for that love, they've already been through multiple changes in technology new focal this is just another evolution if you mentioned product better for them, easier to use, easier to service, easier to upgrade. So these are all, I think, part of leveraging technology, which is one of the Central things that we've had here in the last 5 or 6 years. So we're really trying to do what ADP has been doing for many years with a slight change in emphasis with greater emphasis on product and technology and maybe circling, we had 5 or 10 or 15 years ago.

Operator

Our next question will come from David Grossman with Stifel.

David Michael Grossman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

It's been a while since we've been in a stable rate environment. So could you just help gorgeous review for us how higher rates flow through to ADP? And how much of that perhaps you share with a client that gets reflected in pricing over time?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

So the second part is a tricky question because the way it gets shared, if you will, is it makes company stronger and allows us to for example, theoretically, to be more careful with price increases. None of which -- I guess the answer is, leverage is anything like that. If rates were because of the way our portfolio is laddered, even though we felt multiple years of pressure on a downside, we are getting a little bit of help here on the upside. But there's really, it isn't like an overnight and I remain overnight in the sense of rates. But because of the laddering, there's not that kind of dramatic of a change that we are obviously it's raining men helicopters and have to figure out what to do with that. But we definitely appreciated it is better than it was what it was going to the other direction. So it's all positive. So I think historically, I think carless probably make stronger and more competitive but we really don't -- there's no pricing mechanism. We did raise prices went into slowing, down in rates are down. We don't plan on lowering prices when it goes up. I guess it could be completely direct.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

And I give more couple more technical updates, name there's revenue share of slowed income with any of our clients. But on how that business on the model. And negotiated the price and that some of our products actually declined negotiate with them in the value of the flow and it reflects in the next contract will relationship we want replies. But this is not an explicit revenue share of income.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

And just to be even more clearly, we lost $300 million in float income. And just assuming that the segment about us and that the state is flat. About is actually grew from $15 billion to over $20 billion during that period of time. Tempting And I'm thinking back to life 2007 when we beat our income. So there's a long way to go to get back that $300 million and that would not be even adjusting for inflation and for growth. And as Jan just said, we don't have those kinds of arrangements. Having to increase our presence and that was going on. So we managed to improve our margins and grow our business and the phase of that kind of headwind. And so I think it's -- it feels fair to Weston now enjoy the fruits of better environment and a go forward basis would be the way to look at it.

David Michael Grossman - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay. Understood. And I just have a follow-up to the last question that was asked about a little bit about the product road map for the upmarket. Can you give us a better sense of timing of when you or how you expect to roll out some the new future functionality of which are working on. At the senior Mike, what are the major changes, if you will, that you're making to the new market product.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Whenever said there's a new version to an upmarket product. So you shouldn't see it either. So when what rebuild was we build a platform in which we could build apps that could serve a number of clients. It could be used globally. It could be used in the upmarket, and frankly someday, can be used in the middle markets. So we're not ready. We should industry analysts. Or shared, we're try to share as much information with all of you without sharing so much information but it creates a competitive problem for us. So we're not ready to say exactly what we're doing or where we're going. But I can tell you that the benefits are obviously the usability, speed the changes been to development, cost of maintenance and not to mention cost of development. So there are a number of benefits that we will get from our product development efforts. And that's really only talking about the local development platform. We also have 2 very large investments in back-office systems. So this is our gross to net payroll engine in our tax engine as well. There, we would expect and the plan is to have that be completely transparent. These engines are back-office engines that are really not visible to the clients. They just -- they create outcomes. The front ends are Vantage, some of our other front and products. And so there's no really expected impact assuming that we execute well and the kind of transition if you will the new gross the net payroll and then also tax engine. Expectation for improvement still are fairly significant and it says it will have a lot more flexibility around the things we could do around payments. So we may choose the, we may not necessarily do it, but we'll have the ability to do same-day payments, real-time payments. We'll have a lot more flexibility around the speed to make changes whether that's statutory or competitive changes in our system. And the cost of maintenance and the cost of support will go down significantly based on our business cases that we have for these back-office engines. So these are really modernization efforts because those platforms service incredibly well today a high scale, high reliability and high security. But we believe based on our business cases that obviously, whether it's 2, 5, 7 years down the road, that new technologies can help us leverage those services that we provide much more efficient manner.

Operator

Our next question will come from the line of Jeff Silber with BMO.

Unidentified Analyst

It's henry Chien calling for Jeff. Just a question on the changing guidance for the EPS or adjusted EPS. Could you break out how much of that is the impact of the acquisition and how much is FX if you could?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

The impact for the acquisition would be 0 because 0. It's a great business. Good-sized revenue business unfortunately, is around break even in the way that we describe it. So it's not a huge drag on our earnings. It's not a huge help. It has a small Dragon margins obviously because of break even, but some revenues, doesn't help our I would say no impact in terms of EPS guidance from acquisitions. in the second part of your question was?

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

I can give you a little bit on the tax side. Actually, that's a big chunk of it. It's a little less than 2% of that increase comes from tax and that's just the performance that we have as well as the $0.05 that will ebb and flow that.

Sou Chien - *BMO Capital Markets Equity Research - Associate*

Got it. And FX?

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

I don't have anything here. I don't think it's that meaningful really.

Sou Chien - *BMO Capital Markets Equity Research - Associate*

Okay, okay, got it. And just the second question on booking growth and how it's tracking for the year. Just curious if you have a sense of whether some of the drivers for the rest of the year whether it's the product or by market for new bookings growth.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I think for bookings growth, what we try to look at is the noise in the system's been pretty significant over the last 24 months because first, we had ACA and then we didn't have ACA. So I have 2 press my comments by saying as been exactly businesses well. But in typical businesses as usual for ADP, you would have a headcount increase, a company buy a productivity increase of our sales force, which would lead to our sales results. So the mechanisms that we would -- the buttons that we would try to push the try to increase or improve our R&D business bookings were generally be around increasing our headcount or capacity if you will obsess because we could also spend money on digital marketing and other tools to make our sales force more efficient. And then what can we do around products to drive the productivity. It's all about productivity, like any of our business, a little bit also giving them better products in more things to sell so that they can also grow their productivity that way. So one of the things we did last year is in the phase of the challenges we were having, we decided to actually invest in headcount. We has d, had 2 or 3 years where we were able because a tailwind of the ACA, to lessen the headcount because you are getting more from productivity. And we opted best year in order to get a couple of years of new business bookings. We invested in our headcount. And our thinking about 7% headcount growth year-over-year. That's pretty healthy for us when you look at the last 5 or 6 years. It doesn't have an immediate impact because those people hv to become they have to be ramped up in them to get into the field. But as those people mature, that's an investment that should pay off for us for several years to come as those new sales reps become more mature and become more productive over time. So that answer your question is, the reason we feel good about our format, which, again, is subject to interference by as we saw the government fairly large changing direction 9 months ago. So we can't ever say were 100% sure when we look at certain metrics that give us confidence in terms of what we have in terms of guidance and it's mainly around headcount and modest productivity improvement.

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

And throughout the year, basically, what we'll see in that accelerated headcount growth naturally becomes more productive as that sales force is maturing. And then secondly, it's an easier grow-over so motherly, those are 2 major growth drivers that will make the comparison the second half of the year look that will accelerate the growth in the second half of the year.

Operator

We have time for one final question. A final question will come from Gary Bisbee with RBC Capital Markets.

Jay Hanna - *RBC Capital Markets, LLC, Research Division - Associate*

This is Jay Hanna on for Gary. Just regard to the 3-year framework you laid out recently. Should we expect any change of that based on the fiscal '18 guidance increase given this quarter?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

I don't think so because I think as John said -- first of all, it's early. Where the first quarter and I think you could tell that we feel good about our results. We feel good about the future. But I think is premature. We did get help from tax. We did get a little bit of help from the growth rate from the floating comps. I think it's just too early. But directionally, we feel good. But I think it's way too early to think about how the first quarter impacts 2020 for us.

Gary E. Bisbee - *RBC Capital Markets, LLC, Research Division - MD of Business Services Equity Research*

Okay. And then with the next gen tools and migration you spoke to earlier, is any of that associated with the 500 basis points in margin accretion that you spoke to recently as well?

Jan Siegmund - *Automatic Data Processing, Inc. - Corporate VP & CFO*

Know. The scale and operational improvement that we illustrated margin and long-term outlook is counting next generation products making them meaningful impact for the planning horizon, which ends in 2020. And think part of the recently is that we've obviously we invested a lot already. But now were in the process of where hardening and also getting clients. We do have clients, by the way, the 3 next generation platforms. These are real platforms that we invested hundreds of millions of dollars in over multiple years. So we feel good about it. They're real and they're going to drive long-term efficiency longer cost, stronger sales, better client experience. It's going to -- from a timing standpoint, I think it's clearly way too early I think for us to be factoring those types of improvements into our forecast. But for there's no question that whether it's in 2020 or the last half of 2020 or or '22, these investments are expected to have meaningful impact on ADP's competitiveness and it's profitability as well.

Operator

Thank you. This concludes our question-and-answer portion for today. I'm pleased to hand the program over to Carlos Rodriguez for closing remarks.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Thank you. As you can see, we're off to a really good start, and we're happy that the initiatives that we have around enhancing our service, the innovation of our products and expanding our distribution model are working. And we have obviously a lot of confidence that I think the investments will continue to deliver the results we expected to those investments, especially in the latter half of fiscal 2018 and beyond. Over the last several months, obviously, we've been involved in this proxy contest and I just want to acknowledge for a minute our Associates because obviously, some of them may feel like they're efforts of been put into question during this process. And as I mentioned, think the distractionhas been largely to a small group year but inevitably, our associates also hear some of the noise out of the market. And I just want to thank our associates for the resolve that they've had in delivering to our clients what the clients expect from ADP. And I also want to thank them for their encouragement they've given to us to continue to move beyond the distraction and continue to deliver valuable services to our clients. The dedication, I think, and the attentiveness and the integrity more importantly, of our associates is what makes this company great and it's what our founder, I think, insisted on. I'm And confident that with their help and there's upward, we're going to continue to make ADP successful. I also want extension to thank our shareholders and the confidence they put in our management and our board as you've gone around visiting and talking to investors. Encourages we've got them from them as just strengthen our resolve to continue to do the right thing for them and also on their behalf. And so with that, I want to thank you, again for joining us, and thank you for your interest in ADP.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may all disconnect. Everybody, have a wonderful day.