THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ADP - Automatic Data Processing at Sanford C Bernstein Strategic Decisions Conference

EVENT DATE/TIME: MAY 29, 2013 / 08:00PM GMT

CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Rod Bourgeois *Sanford C. Bernstein & Co. - Analyst*

PRESENTATION

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

(audio in progress) and get started. Thank you guys for being here late in the day. I'm Rod Bourgeois, Bernstein's IT services analyst and very, very happy to close the day with ADP's CEO Carlos Rodriguez. He is going to start with a handful of slides just to clarify where ADP is today in the market and then we'll commence with a fireside chat followed by some questions that we'll pull in from cards in the audience.

Thanks.

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

Thanks, Rod. Since you said a handful it's a challenge. I've more than a handful but I'll try to move through them relatively quickly so you can start the interrogation of me. I appreciate the opportunity to be here and give you a little bit of an update on ADP. I'm going to -- before I get started, I have to give the usual. I'm going to make some forward-looking statements that involve some risks that are outlined here in the slide and also in our SEC filings. And what I'll do today is give you a couple of slides on business overview since some of you may not be familiar with ADP, talk a little bit about the market trends and for us the market is really human capital management or HCM and our strategy to be successful therein and then talk a little bit about some specifics around our financials and our capital allocation which may be of interest as well.

In terms of a quick update on ADP in terms of what we do, we're really a tech-enabled services company. So we're not a pure technology player, but clearly technology is an important part of the services that we deliver to our clients. We operate in two segments, Employer Services and Dealer Services. Employer Services is really the core of ADP and it's really where we sell our human capital management solutions to help clients and prospects better manage their people, assets. And then Dealer Services, which is about $1.7 billion of our total of just around $11 billion is really a business that helps dealerships really manage, market and sell the entire dealership. So we really provide a bunch of different services that I'll go into in a few minutes.

In terms of some quick facts that might be interesting on ADP, we pay 24 million people in the US which is one out of six people working in the US. We move about $1.3 trillion annually in money movement services for our clients on behalf of their employees as well as for tax authorities. We actually processed 48 million W-2s this last year and we've invested over $1 billion HCM innovations, if you will, both on the acquisition front as well as on the R&D front in our business over the last several years.

We're 57,000 associates something that may not be clear to everyone as we are a global organization. So we deliver services in many, many countries and actually in 26 different languages. We have both in country, what we call best-of-breed solutions as well as multinational solutions for companies that have employees in multiple countries as well.

In terms of our financials, we're one of only four US industrial companies, non-financial companies that are AAA rated, the others are Exxon, Microsoft and J&J. So we're a pretty good company. We have about $11 billion in revenue.

The way to really describe our business in a couple of words is we have a recurring revenue model, it's very predictable and very stable. That allows us to really be very good in terms of our capital allocation. The predictability of our business has allowed us to pay a dividend that's been increasing for the last 38 years. So it's a great, really a great business model with capital requirements.

If I can talk a little bit about what's going on in terms of the markets that we serve, which we really call human capital management space, and I'll talk about dealer just separately on one slide. But first in our employer services business what we're doing around human capital management is to address a number of trends that are happening in the marketplace, really starting with an increasing need for help from a compliance standpoint.

When you look at over the last several years, we've had a number of tax changes, the last of which were on January 1st where the payroll tax holiday expired and new tax rates were put in effect for some people really at the last minute creating real quandary and some confusion for clients and people out in the marketplace. Those are the types of things that we help with is making sure that people are on top of those tax changes.

And then the mother of all compliance requirements, the healthcare reform that now obviously has withstood the Supreme Court and also an election is real and it's coming. It's another example of where we really will be able to help our clients meet the requirements that those regulations put forth around providing health care and then also keeping track of who is eligible, who's not eligible depending on how many hours they work.

So compliance is a big factor, it's also a global issue where compliance is not something that's faced by companies just in the US but really faced in every country across the globe.

Another underlying trend is really people desire to better manage their talent and as we ran into the recession, obviously you saw high unemployment rates and people speculating that there would be an abundance of talent out there, and if you needed to hire someone you could. The challenge with that of course is that if you're looking for a construction worker there were plenty of them, but if you were looking for a computer programmer, there weren't as many. And so this issue around finding good people and managing people and managing performance is something that's been a trend for the last 10 years and the recession certainly created a bit of a relief for some companies. But shortly after the recession, I think you saw once again just kind of war for talent emerging and companies really desiring to find ways to better manage their best people and really attract the people that they need in the specialized fields that they're looking for.

Another trend that we're responding to is continuing desire on the part of companies to look for solutions that are really integrated and that are simple and easy to use.

The world is really moving to a place where prospects and clients are trying to operate with fewer vendors and vendors that can really make work easier for themselves but also for their employees in our case since many of the employees of our clients touch our products as well. So things like focus on workflow across multiple functional areas, be it payroll to benefit administration. The time and attendance is an important part of this integration focus.

Another one is really the change in the demographics of the workforce. Besides the fact that there are many demographic changes as a result of age, you look at the newer entrants into the workforce and their propensity to use mobile devices and they want to use social tools really forces us to kind of rethink our business model and how we deliver our services from a technology standpoint. So those are really the four big trends that we're trying to address as we kind of formulate our strategy on a go-forward basis.

[And then just] talking about what we call the human capital management market, we believe that it's a very big opportunity in a big market globally. We believe we've only scratched the surface. And this slide was really just intended to give a sense of the magnitude of the total size of the market and then the size of each individual component.

As you'll see in a few minutes we play in many segments of this human capital management space across the spectrum of different products and services. The good news is that the backdrop for us in this industry is quite positive with independent outside industry analysts saying that this market is really expected to grow and has been growing around 7% compounded for many years and hopefully for many years to come, which is obviously better than the 2% to 3% GDP growth that we're experiencing in the US today.

And how we intend to take advantage of this large and growing market is really by investing more in acquisitions, investing more in our own internally-developed R&D, things like mobile, things like business analytics, things like solutions for healthcare reform that I just talked about a minute ago and also addressing the issues around integration and ease of use that I mentioned in the previous slide.

I think here is kind of a good depiction of kind of what we mean by human capital management. It really runs the spectrum from hiring an employee and the tools you need to help with recruiting and management of the recruiting process all the way to when an employee retires and they need to have either a COBRA notice or they need to have their retirement plan managed as they leave the company. There is a lot of things in between.

We play really in some form or another in each of these areas in the whole human capital management spectrum. One of the most important things that we're trying to do is besides providing services to address each of these individual segments, it's about providing a holistic view to our clients of their workforce to help them better manage that workforce and better leverage the human capital assets that they've invested in.

When you look at the services that we offer it really span almost that entire spectrum that we just went through. It really cuts across all different functions of human capital management, but uniquely to us and not aware of any other competitor that has also across the entire spectrum from a size standpoint. So we go all the way from the simplest, smallest client with one employee all the way through to very large complex multinational companies, but we do it within the human capital management space in the Employer Services segment. That is a little bit of a differentiator for us that we are uniquely focused on this human capital management space.

Again, the integration of all of these products is an important differentiator for us, but the breadth of the products is also an important differentiator. So we do everything from the payroll services which is what everyone knows ADP for and is our core and our mainstay, to time and labor management services, benefits administration services, talent management, help with recruiting, FSA, COBRA, benefits administration really every part of the human capital management spectrum.

So in the end, what we're really trying to provide with really the payroll as the foundation and really as the global system of record, is really an entire end-to-end human capital management solution for our clients and our prospects and it's really a cloud-based solution. So in each of our three core businesses for small, medium and large clients, we have a cloud-based integrated unified database products to really help our clients with their human capital needs. The intention is really to provide a broad but comprehensive workflow-based solution so that when a client hires or one of the managers at a client hires an individual, the entire process is seamless, all the way from starting the person on payroll to putting them on the benefit plans, to setting them up for a performance appraisal when the appropriate time comes for that.

If I can spend a couple of minutes on, now I'll go to Dealer Services just to not ignore Dealer Services. This is about a $1.7 billion business for us. It's very similar in business model to our Employer Services business in the sense that it's a recurring revenue business and it's an outsourced solution for dealerships where we do everything from helping them with marketing their products to actually selling their products to then managing the back office, managing the inventory, billing et cetera and contract management. So really helping market, sell and manage is really what dealership -- the Dealer Services business does on behalf of dealers but also providing analytics and tools for the dealers to be more effective and more efficient at what they do which is ultimately to sell more cars.

This is a business that over the last several years has really performed quite well. As you can imagine it didn't perform as well in 2008 and 2009 when we had the severe recession that obviously put a bit of a damper on car sales, but car sales have now rebounded and are getting back to close to levels to where they were prior to the financial crisis. And this business is clearly benefiting from that improved backdrop at both the manufacturer level and also at the dealer level. So a business that ADP has been in for several decades, many people are not aware of that, but this is a business that we've been at for a long, long time, showing very good growth rates right now and very healthy margins as well.

In terms of a little bit on ADP's financials and our capital allocation, we're pretty proud of the business in terms of the results that we're able to deliver, some of that driven by the fact that it's just a great model. The fact that it's recurring revenue creates an incredibly predictable and stable business model that's allowed us to be able to invest in our business at a reasonable rate, but also return capital to our shareholders. I mentioned the fact that our balance sheet is about as strong as they come with a AAA rating. We generate about close to $2 billion in cash flow of which we only have to invest about $180 million to $200 million in capital expenditures.

Clearly, we spend a lot more than $180 million to $200 million in R&D, but a great portion of our R&D investments flow straight through the P&L and you don't see them in the form capital expenditures. It's already captured in our net operating cash flow. So it's a very friendly business from a capital intensity standpoint.

What we do with our free cash flow that's left over after the small capital expenditure investments that we need to make is really focused on investing in acquisitions to help drive future opportunities and future growth for the business and then returning capital to our shareholders in the form of dividends and repurchases. We've had an increased dividend for the past 38 years, most recently increasing it by 10% last year. And then depending on the level of acquisition activity and how much capital we're using for acquisitions, we tend to use the balance of our excess cash flow for share repurchase on a fairly constant and methodical basis. Our business model is really pretty unique in terms of its predictability and its stability and is something that really we're quite happy about and quite proud of in terms of the results that we've been able to deliver along those lines.

I'll leave you just with one final advertisement, if you will, slide. It's a little bit of self-congratulatory slide on some of the things that we've been able to accomplish and gotten some outside recognition on, but also a couple of final thoughts in terms of what makes us different and I think what we're trying to do to differentiate ourselves from the competition. I think the first one I would mention is that it's important to remember that we are a service organization at our core and the technology helps us and enables us to do what we do with our clients, which is to help them with compliance and answer their questions to make them better at managing their human capital asset. So technology is becoming an ever important part of our business, but the service differentiation is an important message that I think you should walk away with.

Having said that, our focus in technology has increased over the last several years. So the focus on innovation and technology in addition to our service and our distribution capability is something that we're taking very, very seriously and what we're doing about is, we're trying to invest more in R&D so that we are able to actually deliver on the technology expectations that the market and our clients have. We're also doing things to be able to redirect existing resources that we're spending on maintenance of legacy platforms to be able to focus those investments on newer technologies by migrating our clients to our newer platforms so that we're not spending that money on some of the legacy platforms.

So beside the focus on innovation and technology to go along with our historical DNA around service, you should also take away one last thing which is we have a very powerful distribution network. So we have a direct sales force for the most part that has been evolving over the last several years where we're using social selling and also search engine marketing and other new tools to drive better productivity, but at our heart we have a very large direct sales force that is very, very effective and allows us to add additional products and services through that existing distribution network.

So we think with the strength of -- our historical strength of our sales force combined with our strong DNA in service and that differentiation along with what is a renewed effort and emphasis on innovation and technology, I think are going to really lead to, I think, some success for us in terms of winning market share over the next several years is which is what our objective is is to sell more new business bookings, what we call new business bookings, to add to the top of that recurring revenue funnel to ultimately drive the organic revenue growth rate of the Company to higher levels than it is today.

And I think those are my handful of slides. I'm sorry there was more than handful but thank you. Appreciate it.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Great. Well, let's jump into my handful of questions. I want to start by talking about the competitive environment. There is a couple of, what I would consider misconceptions, that I see in the questions that I get from investors about the competition that you're seeing from cloud-based or SaaS based competitors that are out there.

So we were talking before the presentation about Workday and the momentum that they has in their business. The first misconception that I think is out there is that there is these new SaaS players and SaaS players are going to revolutionize your business when in fact you have the original SaaS business model, so SaaS is not new to this industry. So I think there may be a misconception related to that.

And then the other misconception is that there is a perception that these cloud or SaaS-based players like Workday overlap with most of what you do when in fact we wrote a piece in January trying to analyze how much of your earnings comes from clients that would really be a candidate for an enterprise class ERP system and we estimated that it's about 8% of your earnings that may overlap with the target clients of Workday.

So the two questions I have for you, when you look at the SaaS model these emerging competitors, what do they have that you don't have, if anything? And then secondly, how much overlap do you really see in your business versus an emerging player like Workday?

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

Well, in terms of what some of the emerging SaaS competitors have that we don't have it reminds me of something someone told me a few weeks ago, which is that, god was able to build the earth in seven days because he didn't have an installed base. And so I think that is part of the challenge that we have. It's an advantage because it creates $2 billion in cash flow, but we do have an installed base.

So some of our emerging SaaS competitors are really starting from scratch and I think that to some extent creates a clean slate and an ability to move forward. But it provides potentially other challenges down the road that we don't have from a capital standpoint. So today there seems to be an abundance of capital for emerging SaaS players, but that might not be true for other, but that is one of the differences.

We are, as you said, I think believers in SaaS because we believe that we were on this model for many, many years before it was called SaaS. So when you think about around 2000 there was really a term called ASP then it became hosted. And so these are all the different ways of saying I really manage the technology including the hardware for you and provide you a service.

And so we've been operating that way really for decades, even before the kind of the emergence of this kind of term SaaS. So we're believers in the business model. Even to the point of, when you think about the similarities, the subscription model that Salesforce.com and other SaaS players have supposedly invented has been the way we've been building our clients for 30 to 40 years. So the outsource model was always conceptually, we own the technology, we own the hardware, we own the solutions and we basically provide them to you on an outsourced basis. So you don't have to have those investments in that overhead which is really kind of the concept behind SaaS.

And so I think building on a recurring basis either monthly or per employer or however you want to term it, is something that we've been doing for a long, long, long time.

So where the threat really emerges is our inability -- if we had -- if we don't keep up with the application of SaaS technology to the solutions that we provide that's really where there's a big risk. And hopefully by the tone of my comments you can tell that we're investing heavily in our own SaaS platform. So in small business, mid-market and in national accounts and all of our major segments, we have new fully cloud-based SaaS solutions that are out of the marketplace today being sold. The challenge of course is that we have a legacy base that we have to now bring along.

But we have been investing because the technologies clearly have changed. So whether you call them SaaS or hosted or ASP, technology today allows you to have version-less upgrades, allows you to make changes much faster, allows you to -- the cost of change and development is much lower. So adopting new technologies is incredibly important for ADP to be able to compete effectively against some of the SaaS players, but I think it's important to add that we've been through that numerous times in our history. So our company is 60 years old and there have been -- nobody in this room, obviously, would remember punch cards, but we went from punch cards to PCs, from PCs to the Internet, from the Internet to what is now called SaaS or cloud-based technology. And I think we've made those transitions successfully by embracing changes in technology and leverage them to make our business model healthy and to provide better solutions to our clients. So we don't see it as a threat, we see it as I think an enabler to do what we do better.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

When you sell to a client, what's the biggest difference in your value proposition versus a Workday or an open software, I mean -- and how much of it is the service that you're able to provide to the clients?

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

Well, ironically, I mean, you said it, I didn't -- instead of calling them [ultimately] you called them Ultimate Software. And so I think the difference is, we're really not selling software. And I think one of the misconceptions is that SaaS in and of itself if it's still a software solution to software, it's better software than it was 10 years ago.

It's a version-less, it's subscription base, there is a lot of positive, but it really is still software. So I think what Workday and Ultimate are selling is really a software solution. And what we're selling is what we've always sold, which is a technology-enabled services solution. So we help, for example, with compliance.

So when now clients have questions about changes in tax policy at the end of the year or now we're getting a lot of questions about healthcare reform, we believe it is our role to help our clients navigate through those changes, but more importantly comply with those changes, not basically sell them a software product that then becomes their responsibility to really comply with those changes in regulations than in rules. And that doesn't involve only taxes and healthcare reform, but it involves things like time and attendance and other parts of our business where we had an additional service layer where we help clients with insight and expertise in addition to just providing them a solution then letting them handle the work themselves with their own internal resources.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

And then just to help us break down the competitive overlap in your client base that you would have with a company like Workday, so you have a small, medium and large client segment. In your large client segment, it's probably less than half of those large clients that have more than 10,000 employees which generally are the candidates to buy an enterprise class ERP system. And then within that group of employees you have payroll which is typically two-thirds and beyond payroll which is one-third.

Is it really in just that subset of clients really where there is you're selling beyond payroll to a client that's more than 10,000 employees where Workday is the biggest threat, is that the way to dimension where the overlap is big?

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

I think our -- let me just start by giving a quick overview of what we think the market -- how the market breaks down because our research shows that there are buyers who want to buy software and there are buyers who want to buy an outsourced solutions in all the segments, both in the small end, the mid-market and also in ERP and the higher end.

And the propensity to go with either of the solutions has over time changed slightly but you still have buyer preference where, for example, in the small-end of the market Intuit is what we would call a software provider and we would be considered an outsourcer that kind of do it yourself buyer in the low-end tends to continue to be a do it yourself player. Some migrate to outsourcing and some go from outsourcing to do it yourself, but they tend to have different preferences from a buyer standpoint. So we tend to differentiate ourselves by being in the prior -- in the buyer preference segment that wants outsourcing and service versus kind of a pure software solution.

So I think the threat to us is if there were large changes in buyer behavior from one category to the other i.e. going from outsourcing to a pure software solution, which we have not seen thus far, but it's something obviously that we watch very carefully.

I think that as long as you're providing real services with real value in addition to the software, it doesn't seem like an enormous threat because someone has to provide those services. So it's about whether you want to do those services yourself or you want to leverage someone else's scale and expertise to provide those services. But the compliance services, for example, don't go away. So the tax filing is a key component, for example, of our payroll business and if you buy a Workday software solution, I don't know if anyone would be surprised by this, but you still have to go and use someone for tax filing which by the way, in many cases is ADP because we provide stand-alone as compliance services as well because the Workday product doesn't automatically pay government entities for taxes or make sure that the tax rates are reconciled and doesn't really respond to requests from the government for amendments or questions. So there are still other vendors you'd have to use, which is what Workday does today. They have partners that they work with, including us, for tax and compliance.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Right. So when you look at the cloud and SaaS players, they are really targeting a do-it-yourself market, which is really a different target client base. That makes sense, especially in the small business segment. But it seems that in the large client segment, there is another dynamic, which is a lot of your growth opportunity is to move into these beyond payroll services or the broader human capital management space and Workday has, particularly with talent management, Workday has a great reputation. So it does seem in the large client segment, it's more than just Workday chasing the do-it-yourself buyers, it's also that they are accessing this growth opportunity, which I think is one of your most promising growth areas. Is that an accurate portrayal of what's happening?

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

I think it could be, but I would just want to clarify that, I think Workday's focus is really on the ERP vendors, and clearly, we could see a casualty along the road, but I think their target is really SAP, Oracle and other ERP vendors because they're building out things like financials like accounts receivable/accounts payable, something that clearly ADP is not doing and for the time being not interested in.

And so they still appear even though it's differentiated in the sense that it's new technology, it's SaaS, it's version-less, it's easy to use, there is a lot of positive things about the Workday product, but it's still ultimately a software ERP solution and not an outsourced solution. So I think there will be some segment of the market that will want Workday always has been that will choose Workday instead of Oracle or SAP, but I think we see still that there is a very large segment because we're selling. It's not like we stop selling when Workday went public. We sold a lot of business since Workday went public. But clearly there's still a number of prospects and clients out there that are interested in the kind of the outsourced solution as well.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Got it. Now when you look at your client base, you have clients in all three of your client segments, small, medium and large on legacy product, but you've also built these new SaaS based product platforms. In the small business segment, you've made a lot of progress in converting clients from legacy to the new platform and presumably that should be helpful as you convert larger clients to the new platform.

Is the conversion of larger clients being enhanced that the pace of it and the efficiency of it by the experience that you had in the small client segment in converting clients from legacy to the new platform?

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

I think that it's -- I do hope that it will be an inspiration to the people in our large business, but we are -- we do have different leaders for the different segments of the business. And one of the things I'd like to tell people is, Intuit doesn't against Oracle and Oracle doesn't sell against Intuit. So they are different markets with different needs. So I don't think there is going to be a direct correlation between what we're doing in SBS in the small business market and our national account migrations or conversions other than it will serve as ammunition for me to further encourage, because I think it's important from a competitive standpoint for us to have our clients on our latest and greatest platform.

It doesn't make sense to sell it only two new clients, although that is helpful also because we like to gain new market share, but we have to move as fast as possible in all three of our segments to get our clients onto our latest and greatest platforms. And I think success in any of those three areas will, I think, create some momentum for the rest of the Company to kind of see that this is net net a positive, because as you can imagine there is natural resistance, there is inertia both at the ADP level and at the client level to change.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Right.

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

That inertia is dangerous from a competitive standpoint.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Your competitive threat is greatest when they're on the legacy platform.

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

That's correct.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Can you give us an update in each of your three client segments on where you are in converting from the old to the new? Are you sort of at 50% in the small business and a much lower number in the large segment? Can you give us the exact numbers?

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

So we're a little over 50% in the small market segment.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Okay.

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

So we're making really good progress and the momentum is picking up.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Good.

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

And that's from not being very far along last year that we had gotten a little bit further along as a result of natural attrition of our legacy base because client retention--

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Right.

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

--is kind of, call it, low to mid 80%s in that small business segment. So you lose a certain amount of business every year. So as long as you're not selling new clients on the old platform, you naturally make some progress. But in the last six to nine months, we really started a concerted effort to migrate in small business and I'm really quite impressed by perhaps with the incentives that I've given them which are significant, but the momentum is really picking up and we're picking up steam now in terms of those client conversions. So it could be as quick as 24 months for us to be completely off of our old legacy platform in small business. And we only have two, so that would put us on a single platform for smaller clients.

In mid-market, we're probably 50% of the way of getting our clients onto our Workforce Now platform, but we have a newer version Workforce Now which is Workforce Now 4, which is ultimately the true SaaS version-less platform that we want to get everyone on to. So that's going to take a little bit longer, but we're half way in terms of getting people from our legacy PCPW client base onto a Workforce Now platform.

And then advantage in the national account space, we literally are just starting--

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Starting, okay.

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

--to really think about conversions.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Okay, great. So I want ask a numbers question just to set the context. In the last 12 months, your bookings growth is about 12%. In the last quarter that you reported your organic revenue growth was 6%. Consensus a year out is forecasting 7.3% revenue growth. And when I bottom-up build the growth rates in your underlying segments, it seems that you have the propensity to grow at around a 9% revenue growth clip. That's just bottom-up estimates on our part.

So your bookings growth is implying a better growth rate than your current growth and even a better growth rate by a meaningful margin than what consensus is assuming a year down the road. So can you talk about what's happened with bookings? Is there something lumpy in the bookings or is there a bookings quality issue or is there just literally a time lag that's going to be required to get your revenue growth commensurate with where your bookings growth has been?

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

Right. So it's a great question, because we want the things to add up. So unfortunately I have to digress on to the interest rate topic because in our business model the client funds interest is actually part of our top line revenue [where in] most companies interest income or expense is really below the EBITDA line. For us, it's part of the core business. So the fact that that number is down $100 million year-over-year for the last two years, if you think about $10 billion in revenue, it's about 1 percentage point drag on growth.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Each year?

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

Each year. So if you think that if the Company is reporting 7% revenue growth, excluding interest drag, it would be 8%. And by the way, if interest rates ever move in the other direction, you could then get revenue lift, right. So even though you're growing organically 8%, you might get 9% because now you have interest income adding to the growth rate rather than subtracting from the growth rate. So I think that's one mathematical thing that we need to cover.

The other one is FX. So we've had a couple of quarters this year at the beginning of the year where we had some drags from FX rates in Europe which are not as impactful to our bottom line margins but really impacted the revenue growth at the top.

But I think if you see our -- if you take into account those two things and you take our recurring revenue base where our retention rate is and you look at new bookings and I think our guidance for this year for the 12 months is 8% to 10%, so call it 9% growth in bookings.

I think you'll see that it adds up. If you then add on top of that around a 1% net price increase, so our price increase net of concessions and so forth tends to be around 1% of revenue growth per year, and then we get a little bit of hope from pays per control growth which is the natural growth of our client base. So I think if you take all of those things together, I think you get to a growth rate that makes sense compared to what you might have thought. The 1% interest rate drag is a fairly --

---

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Meaningful, yes.

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

-- significant part of the whole picture.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Okay. That's very helpful. Some questions coming in from the audience as well. So can you give us a picture of what your business portfolio, your business mix would look like three to five years out? And specifically, can you address whether it's a consideration to at some point [does that's] Dealer Services? So how are your business mix shift over the next three to five years and is dealer necessarily a part of the equation?

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

So dealer -- I think our position on dealer has been consistent for many years ever since we embarked on kind of the simplification of our portfolio when we spun off brokerage which is now Broadridge, which I think was here -- is here at the at the conference. So we spun off brokerage, we sold the claims business and then we opted to keep dealer, and I think that our criteria was as long as dealer is additive to the growth rate of the Company from a revenue standpoint, but also from a shareholder return standpoint, then we would keep it because we felt that it had positive growth prospects, particularly outside of the US.

Now this is of course pre-2008 and 2009 and that meltdown of the economy of the auto sector clearly raised some questions about the long-term, I guess, involvement of us in that business. But of course now nobody is questioning it because now it's growing 8% to 9% top line, it's got good margin expansion, the business is performing quite well. I think what's obvious is that business is a little more cyclical than our Employer Services business, but otherwise it actually has a lot of similarities to our business in terms of recurring revenue, the way that it uses technology to enable a service that it provides to its clients and it's a deep vertical where they have very tight relationships with their clients.

But I understand the question, because again we would -- I think [it'd be] less than honest if we didn't say that we have those discussions and that's something that the people in Dealer Services understand that we're having those discussions, that we're always evaluating and they know what the criteria is. So they have an incentive to continue to deliver and to perform, because it is a business that in a non-performing environment we would probably want to still be in.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Okay, great. As you move clients off of the legacy platforms onto the new platforms across all your client segments, do you ultimately get a margin benefit? And just [for some] numbers for the audience, I mean, excuse me, ADP's software development and programming costs are about 6% of revenues and clearly those costs have been affected in recent years by the need to build the new platform. So clearly in that bucket as you move to non-redundant product platforms, you'd probably get some benefit, but even beyond that, are there margin benefits related to customer service being less complicated with your only supporting one platform in terms of two. So ultimately the client here wants to know, does it help your margins and your return on invested capital as you move to single product platforms.

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

Well I think it's insightful that the question was really framed around, that help you in terms of your client services cost and another costs besides R&D because from an R&D standpoint, clearly if people think that what I'm signaling is that we're going to spend less R&D that would be wrong message to take away because we're investing more in R&D.

So I think the importance of innovation not just in building new platforms, but integrating them tightly, creating better user experiences, all those things are things that we're going to continue to invest more in not less in. Having said that, part of the reason we're moving our clients to common platforms is to eliminate costs that today are being really used to maintain old legacy platforms that aren't focused on innovation.

So I think our need to invest more in R&D will be less if we have fewer platform so that we think that would be obvious. But what's not so obvious and was the gist of the question, which is a great one is, I believe that the biggest leverage of this kind of simplification of our rationalization of platform is on the back office, the service costs, training costs, the frictional cost of selling. So just enormous benefits to being in a simpler environment where you don't have two sets of service people that are going to different training sessions. So we believe, based on some experience on conversions or migrations that we've already done, that there is a lot of potential operating leverage, not necessarily in the R&D side, but more on the operating costs side.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Perfect. So a couple of questions about the PEO business. So can you speak to the opportunity in the PEO market in the context of healthcare reform, the competitive landscape there as well and just to give the audience in numbers, I mean, ADP started the year in the PEO business for fiscal 2013 guiding the 13% to 15% revenue growth. The latest guidance calls for 12%. So very good growth in that market, although it's been ratcheted back some. So what's the growth opportunity in PEO and how does healthcare reform play into it?

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

So first in term on the actual facts in terms of the growth rate, that business is unique in the sense that it has a lot of pass-through cost that are really insurance related, especially on the health insurance side. So we sell health insurance as part of the package. We're not the insurance company, but we resell insurance products to our clients, which is part of our revenues.

Those healthcare inflation rates historically have been much higher than they have been in the last couple of years, particularly this year. And so the decrease in the growth rate is almost exclusively related to slower inflation of [passing] costs which really don't impact our profitability or margin. They only impact the top line number. So it's not really a reflection of -- the ratcheting down is not really a reflection of the health of the business one way or the other.

Having said that it's a fair question like healthcare reform is something that we're thinking hard about all of our businesses and the impact on different parts of our organization. The PEO really acts like one large employer. So our health plans are really large employer plans where the clients come to us in essence because we're already acting and what the government really wants to create which are exchanges, right. So the PEO is somewhat of a giant exchange where small companies with 20, 30 employees get the advantage of being in a plan that covers literally tens of thousands of employees what we call work site employee.

So in an ironic twist, we think that the PEO model could drive, there's no way to know for sure because a lot of healthcare regulation is still emerging and it's not completely clear how the market is going to react or clients going to get off of PEO to go to a government exchange, hard to predict all that, but our plan is to actually grow that business, not to take it backwards as a result of health care reform. I believe there is an opportunity to create.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Nice. What would be the impact on your business if you lost your AAA rating or do you need your AAA rating?

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

First of all, we like our AAA rating and we would love to keep it. I think it helps us with access to the capital markets. [When someone would say] well, you never access the capital markets and the fact of the matter is we do use commercial paper quite vigorously for our laddered portfolio strategy and access to the commercial paper markets in 2008 and 2009 was an import thing from a liquidity standpoint for our business model.

So we like our AAA because of the access it gives us to the capital markets which just allows us to do the laddering strategy, which allows us to earn probably an incremental $200 million to $300 million over the last five years than we otherwise would have have we've been short the whole time.

So I think it was the practical reason why we like the AAA, but another reason is really differentiation. So I think giving your sales force any tool possible to win in the marketplace is important and it's a good marketing advantage for us, particularly with large enterprise global clients to give them the assurance that when we're moving $1.3 trillion of which some of it is their money that we have a bulletproof balance sheet, I think is an important marketing, I think, advantage that we have vis-a-vis some of our competitors.

So if we weren't moving money and we weren't doing compliance, it would probably be less important, but I think it does provide some value to us, but it probably wouldn't be end of the world if we didn't have a AAA ratting.

Rod Bourgeois - ***Sanford C. Bernstein & Co. - Analyst***

Has your view on that changed since the financial -- during the financial crisis? In other words, did you think about the AAA rating differently before the financial crisis back in 2008, 2009?

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

Yes, I think there were -- there were I think discussions internally which by the way we still have because it's okay to have these discussions about why do you need the AAA to the nature of the question, should you leverage up, buy back shares, all kinds of things you could do from a flexibility capital standpoint if you didn't feel like you needed to have the AAA.

We've looked at all of the possibilities, all of the alternatives and there is really no approach like us leveraging up and borrowing $4 billion to $5 billion to buy back shares doesn't really change the game that much for us.

And so we haven't found a compelling -- if we found a compelling reason to give up the AAA, I think we would. And in 2008 and 2007 or really more 2007 and 2006, there were many discussions around is this something that we want to give up to do other things, pursue other things, and I have to say that once we've passed the experience in 2008 and 2009, there was a renewed appreciation, particularly for a few months of having a AAA and a balance sheet like we have.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

Great. So quick question here, would tax rate simplification [or] lower rates in the US worry you in terms of demand in your business since a big part of your businesses relates to the tax withholding process?

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

It's a great question. I think that when you think about -- the government is really not looking for reductions in revenue, it's looking for behold for simplification of the tax code. So if there is a complete rewrite of the tax code and rates went down to 25%, but all the loopholes and all the -- I am talking about now corporate rates. We can get to individual rates which is the same issue that it's just a highly complex tax code. But whether it's individual rates or corporate rates, if there was an enormous simplification, the government would be looking for a revenue neutral solution.

And so the people who would suffer, in my estimation, are tax preparers, accountants and so forth, but if the total amount of money being moved for taxes from withholdings and if our employment taxes stays the same and then there is no net impact to ADP. So I mean there's several taxes that we handle. There are local and state taxes, which are probably not going to go away or go down. We do withholding taxes for personal income tax which are not likely to go down. They could change in terms of when you do your tax returns, how that filing, how many deductions you have and how many loopholes there are, but the total amount of money paid in taxes is not likely to go down.

And then lastly unemployment tax, the two big employment taxes are Medicare and social security, they just pass the Medicare surtax of 0.9% on anyone earning over $250,000. So it doesn't feel like the trend there is to reduce Medicare taxes. And social security, you know the story on social security in terms of fiscal issues that it has. So the trend there is probably to increase social security taxes, not to decrease them. So it's not something that we can take for granted, but it's not something we spend an enormous amount of time thinking about. We think it's an unlikely thing that there will be a change in the tax structure that would negatively impact ADP.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

Sure. Okay. Excellent. We haven't spoken much about margins. Let me ask a question on the margin front here. Your margins last quarter were down 20 basis points year-over-year, but if you take out the impact of the lower flow yield and your acquisition investments, operationally your margins were actually up about 110 basis points. So despite investments in technology redundant product platforms, you've been able to find operational margin improvements.

Do those operational margin improvement opportunity still exist to the same degree? As you look into fiscal 2014, it becomes a pretty relevant question.

THOMSON REUTERS

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

Well, first of all, we appreciate you noticing, and second of all, I would say that I think what's helping us is our organic growth rate is getting better. And so our ability to drive as you mentioned at the very beginning higher new bookings keeping our retention strong has added more revenue to the top of the funnel. The amount of profit that flows down from incremental revenues is quite good as in probably most companies it is. So some of the margin improvement has come as a result of better organic growth, which has been helping us. So even though we're spending more on R&D and we have some frictional costs around migrations, the top line organic revenue growth improvement is helping in terms of that margin expansion.

In terms of what is the potential for the future in terms of margin expansion, we do think there is still room there. When you look at ADP's overall pretax operate margin, it's pretty darn good, but when I stack it up against other companies that are in similar industries to us, I think there is plenty of room there. So we have one or two competitors that have higher operating margins than we do and that would be good example of how much space, how much room there is.

So we believe there is room inherently, but I think there are data points out there that would lead you to believe that a 20% pretax operating margin is nice, particularly for some other industries, but in our world it leaves, I think, plenty of room for improvement over the years.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

And can you access that margin opportunity without a trade-off on your revenue growth?

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

Well, clearly our intention would not be to do that, because as I just mentioned that's part of how we achieve that --

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

You need to leverage, yes.

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

-- that margin improvement. But I think platform rationalization, simplification of our business processes combined with a little bit of help from organic growth, interest rates would help, pays per control on a decent economy help. I think the number of things that I think collectively can help us drive improved margin. So I think -- I don't think our plan is, certainly not the -- the strategy is not to slow the revenue growth down in order to improve margin. That's not -- it's the opposite, it's to increase revenue growth to drive more margins.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

On the pricing front, you have near-record client retention. You've rolled out new product functionality. So that would seem to favor pricing power as you move into next year. On the other hand, the market is more competitive than it was five-plus years ago. Are you feeling better about your pricing power today than you maybe were a year or two ago or similar position?

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

I think it's a similar position. I'm very thankful that, Gary, my predecessor -- this was in probably 2009 or 2010, shortly after the recession, I think, we recognized that pricing was not the button we wanted to push hard on even though we have pretty good pricing power that's not where we wanted to really push the button hard. And so we actually did less in price increase than we had historically done after the recession.

And I'm trying to continue that same approach because we want to win, we don't want to ever think that the reason we're losing is only because of the price. And I think, we are the market leader, so we should create a pricing umbrella and be able to get a premium. But how far our pricing moves away from the typical competitor, I think is important and keeping that difference to a reasonable level, I think is an important objective of ours. So pricing is not a place where we are pushing hard.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

Recent history has been around a 1% price growth a year, is that the same idea at this point?

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

Exactly, right.

Rod Bourgeois *- Sanford C. Bernstein & Co. - Analyst*

Okay, wonderful. With that, I'll go ahead and wrap up. If we didn't get to your specific question, feel free to come up and yell at me afterwards and hopefully we can try to answer the question in a follow-up. Thank you guys for being here. [Let's hope that] we can help with the follow-up. Thanks.

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

Thank you very much. Thanks, Rod.