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ADP - Q1 2016 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

ADP reported 1Q16 diluted EPS of $0.68. Expects FY16 revenue growth to be 7-8% and adjusted diluted EPS growth to be at the low end of 12-14%.

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PRESENTATION

Operator

Good morning, my name is Ben and I will be your conference operator. At this time, I would like to welcome everyone to ADP's first-quarter FY16 earnings webcast. I would like to inform you that this conference is being recorded.

(Operator Instructions)

I will now turn the conference over to Ms. Sara Grilliot, Vice President, Investor Relations. Please go ahead.

Sara Grilliot *- Automatic Data Processing Inc - VP of IR*

Thank you, good morning, everyone. This is Sara Grilliot, ADP's Vice President, 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 FY16 earnings call and webcast.

Before we begin, you may have noticed in this morning's earning release that we are now including a condensed statement of cash flows to assist you in updating your models ahead of our quarterly 10-Q filing. We will also discuss certain gross measures on a constant-dollar basis which adjusts for the impact of foreign currency. You will see similar comparisons in this morning's earnings release and in our SEC filings.

In addition, with the introduction of long-term debt to our capital structure during the quarter, we are moving away from a discussion of pretax earnings and pretax margin and will instead discuss earnings before interest and taxes, or EBIT and EBIT margin. We believe this change best reflects the operating performance of our business.

For ADP, EBIT includes interest income and expense associated with our client funds extended investment strategy, but excludes all other interest income and expense incurred such as interest income earned on corporate funds outside of the client funds strategy and interest expense incurred on long-term debt. Since the client funds extended investment strategy is a fundamental operating component of our business, we believe this approach best measures our operating performance.

During our call today we will reference these and certain other 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.

To begin our call today, Carlos will start with some opening remarks and then Jan will take you through the quarter's results and an update on what to expect for FY16. I'd like to remind everyone that today's call will contain forward-looking statements that refer to future events and as such involve some risk. 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.

With that, I will turn the call over to Carlos.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

Thank you, Sara, and good morning, everyone. This morning we reported our first quarter of FY16 results with revenue up 6%, or 9% excluding the impacts of foreign currency translation. In addition to this solid revenue growth, we also continued to report very strong new business bookings performance which grew 13% in the quarter.

We're off to a good start and as a result, we now anticipate full-year new business bookings growth to be up at least 10% compared with our prior forecasted range of 8% to 10% growth. We have solid momentum as we deliver client-driven innovation that leverages our scale and deep HCM expertise to win a competitive industry.

Our ability to meet a wide range of client needs with leading solutions is unique in the industry and get stronger every day. I'd like to give you a few examples.

Last quarter we told you about our introduction of ADP DataCloud which leverages ADP's unparalleled data to deliver workforce analytics that help boost productivity, develop talent, increase retention and identify potential flight risk. More than 1,200 ADP clients are already taking advantage of these analytical capabilities.

Earlier this month we introduced benchmarking capability to the DataCloud analytics platform. This new benchmarking solution provides users with unique insight from real anonymized up-to-date data. With many companies experiencing a war for talent, this new tool will provide HR teams with key industry workforce metrics for quickly identifying changing market trends. We believe that access to the right information at the right time will help companies create successful engaging work environments.

You've heard us talk about the breadth of our portfolio in terms of serving clients and their employees from hire to retire. On the front end of that continuum, I'm proud to share that Forrester Research recently named ADP a leader among talent acquisition vendors that help clients proactively search for, find and nurture job candidates.

And for those new employees hired by our clients, we just introduced a new on-boarding solution that harnesses human resource data to personalize the on-boarding process. We are really excited about this new product as on-boarding is often characterized by mountains of paperwork and a lack of understanding about an employee's new role, team and culture.

This new on-boarding solution, a product of our innovation labs, delivers a simple enjoyable on boarding experience that helps get new hires positioned for success before their first day on the job. And it's another example of how ADP is innovating across the HCM spectrum.

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Let me turn now to the Affordable Care Act. ADP has decades of experience in helping clients of all sizes meet the challenge of new compliance requirements. Since the ACA was enacted in 2010, our approach has been no different. Our health compliance solutions have been particularly well-received in the market and their adoption has out-paced our internal expectations.

But while we're excited about the business opportunities ACA has created for ADP, let me be clear this is not easy work. We've added significantly to our implementation organization to address the demand and we have teams working around the clock to get our clients live on our ACA solutions. We are pleased with the progress we've made and proud of the many associates were showing extraordinary dedication to help clients navigate these uncharted waters.

The high demands on our implementation and service organizations will continue but I am confident that ADP is able to deliver on our client commitments. To deliver on these commitments, we told you that we will continue to invest in our business to convert these new sales to recurring revenues. We are confident these investments will reward us with profitable revenue growth and even deeper client relationships over the long-term.

Another way we are helping clients manage the cost of compliance of healthcare reform is through our new ADP Private Exchange offering which we introduced in August. ADP's flexible private exchange enables employers to build and implement a healthcare insurance exchange strategy that can help control costs and engage their employees.

The solution delivers an end-to-end exchange experience for the employer, including an engaging retail-oriented shopping experience, defined contribution plan administration, public exchange enrollment, ACA compliance and spending accounts. All of this is integrated with and powered by our broader set of HCM solutions. Once again we have brought our technology and expertise together in a way that's meeting an acute client need at a time when businesses are racing to adapt to changing regulation.

Separately, I'm proud to share that our ADP marketplace won two prestigious designations from Human Resource Executive Magazine, including Top HR Product of the Year and Awesome New Technology. We were excited to have received these recognitions at HR Tech in Las Vegas and last week, as they provide some nice validation for our client-centric view of enhancing HCM capabilities.

We're excited about the potential for this platform to make it easy for clients to extend the value of their investments in ADP's HCM solutions while helping us strengthen client relationships. Innovation is a job that's never done and we're proud of our progress.

Before I turn it over to Jan for a discussion about the quarter's results, there are a couple of things that I would like to mention. First, during the quarter we executed on our strategy to enhance our capital structure with the issuance of $2 billion in senior notes which are intended to fund incremental purchases of shares over the next 12- to 24-month time period. This action is consistent with our communication at our March investor conference when we acknowledged our leverage capacity available within our AA credit ratings category and our intention to be thoughtful in our approach to changing our capital structure. These actions, the debt issuance and the share repurchases, are intended to enhance total shareholder return over the long term.

Second, I would like to take a minute to talk about client retention. Our client retention has been at ever-increasing historical highs for the last several years, leveling out at 91.4% over the last two fiscal years. This is a very solid performance that we have been very proud of, so we are naturally disappointed to see a decline of 160 basis points in the first quarter.

We take client retention very seriously and are highly focused on this key metric. Some client losses were anticipated of course, given the anticipated churn that comes with moving clients from legacy platforms to our new cloud-based solutions. However, we were disappointed to see an elevated level of losses from clients on mature technology.

In addition, there's a lot of activity in the marketplace right now as clients choose providers to help them comply with ACA. Clearly, we have experienced benefits from that activity through higher new business bookings, but the increased level of implementation activity of ACA solutions combined with the movements of clients to new platforms has put higher demands on our service organization.

We know we have opportunities to enhance the client experience to ensure our customers recognize the value of great software and services that ADP delivers. My team is squarely focused on these opportunities and I have full confidence, given our track record, in our team's ability to execute.

We're off to a good start but we have a lot of work ahead of us in FY16. The challenges of ACA compliance have impacted our clients and are causing some disruption both in the market and within ADP, as we sell and implement these new solutions and also prepare to answer the many calls and inquiries we expect to receive from our clients in the coming months.

We have increased our forecast for new business bookings and along with that comes increased cost, not only in the form of selling expenses but also in operational resources to install and support this new business. As a result, we are now expecting to be at the bottom end of our forecasted range of 12% to 14% for earnings per share growth.

So as I said, we have a lot of work in front of us and likely some challenges ahead which may require some further investments. But I firmly believe that as we successfully execute against our strategy, we will continue to drive long-term results for our clients, our associates and our shareholders.

With that, I'll turn the call over to Jan for a further review of the first-quarter results.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you very much, Carlos, and good morning, everyone.

Before I begin, during the quarter we sold our AdvancedMD business and realized a gain of $29 million. The results of this business, which historically were reported in the employer services segment, are not reported as discontinued operations and have been moved to the other segment for comparative purposes, both in the current period and all prior periods presented.

The restated segment amounts can be found in the supplemental schedules on our investor relations website. My comments on the quarter's results and our FY16 outlook exclude the impact of the $29 million gain on the sale of this business.

ADP revenues grew 6% in the quarter or 9% on a constant-dollar basis. Earnings before interest and taxes, or EBIT, grew 6%, or 8% on a constant-dollar basis. This growth is inclusive of investments we have made during the quarter to increase operational resources in support of product implementations. EBIT margin increased about 10 basis compared to 17.5% in last year's first quarter.

Diluted earnings per share grew 10% to $0.68, or 11% on a constant-dollar basis, and benefited from a lower effective tax rate and fewer shares outstanding compared with a year ago. And, as Carlos mentioned, our new business bookings started strong for the quarter with 13% growth.

Overall, our results in the quarter were good, yielding solid revenue growth despite continued headwind from foreign currency translation. And as anticipated, earnings growth was slower in the quarter due to expected investments in the resources to implement HCM solutions that will add to our future recurring revenue growth.

In our employer services segment revenues grew 3% in the quarter, or 7% on a constant-dollar basis. As Carlos discussed, client revenue retention decreased 160 basis points for the quarter from elevated losses in legacy client platforms.

Our same-store pays per control metric in the US grew 2.3% in the first quarter. This is slower growth than we have seen in the past several quarters, however we still expect to see 2% to 3% growth in this metric for this year. Remember that 1 point of growth in pays per control contributes about $20 million in total revenue to ADP.

Average client fund balances grew 3% compared to a year ago, or 6% on a constant-dollar basis. This growth was driven by additions of net new business and increased wage levels compared to the prior year's first quarter.

Outside the US we continued to see solid revenue growth and margin growth, driven largely by the success of our multinational solutions which continued to perform well. Employer services margin declined about 50 basis points in the quarter. The decline is largely in line with our expectation and reflects increased selling expenses and investment in implementation resources to install and support ADP health compliance solutions.

The PEO continues its track record on solid performance, posting 18% revenue growth in the quarter. Average worksite employees grew 13% to 389,000. A portion of the 18% revenue growth was driven by increased benefit costs and higher benefit plan participation from our worksite employees during the quarter.

We believe this gap between revenue growth and worksite employee growth, which has consistently ranged between 2 or 3 point quarter, will return to normalized levels for the balance of the year. Along with this revenue growth, the PEO delivered margin expansion through lower selling expenses and operating efficiencies, expanding margins by approximately 130 basis points in the quarter.

Both of our segments performed well in the quarter, and as Carlos mentioned, we are off to a good start but we also have some opportunities and challenges ahead. As a result, we have revised certain aspects of our full-year FY16 outlook.

First, as Carlos mentioned, to reflect the strong start we had in new business bookings, we now expect bookings growth of at least 10% compared with our prior forecast of 8% to 10%. With the divestiture of the AdvancedMD business, which was included for full year in FY15, but only two months of FY16, we have reduced our revenue expectations for the year by almost 1 percentage point. As a result, we are now forecasting revenue growth of 7% to 8% compared with our prior forecast of 7% to 9%.

And just as a reminder, because of continued negative pressure expected from foreign currency translation, as well as timing of recurrent revenue starts from new business bookings sold during the fourth quarter of FY15, revenue growth is expected to be below the guidance range in the second quarter and above the guidance range for the third and fourth quarter. On a constant-dollar basis our total revenue growth is anticipated to be 8% to 9%.

Our revenue growth forecast for the employer services and PEO remains unchanged. However, I would like to remind you that we anticipate 2 points of negative impact to employer services revenue growth in the second quarter from foreign currency translation and about 2 percentage points for the full fiscal year.

Consistent with our new approach of discussing EBIT margin expansion compared with our prior practice of discussing pretax margin expansion, we will now be providing a forecast for EBIT margin expansion. For FY16, consistent with our prior forecast of 50 basis points of pretax margin expansion, we anticipate adjusted EBIT margin expansion of 50 basis points from 18.8% in FY15. Our segment margin expansion forecasts for the year are unchanged.

For the client funds extended investment strategy, we have lowered our forecast due to revised market expectations which now assume a delayed increase in the fed funds rate, as well as lower fixed income new purchase rates compared with our prior forecast. We are now anticipating that client funds interest revenue will increase up to $5 million compared with our prior forecast of an increase of $5 million to $15 million.

The total contribution from the client funds extended investment strategy is now expected to be about flat to last year compared to our prior forecast of an increase of up to $10 million. The details of this forecast are available in the supplemental slides on our investor relations website.

For the fiscal year, while we still expect growth and adjusted diluted earnings per share of 12% to 14% compared to the $2.89 FY15, we now expect this growth to be at the lower end of the range. On a constant-dollar basis our adjusted diluted earnings per share growth is expected to be 13% to 15%.

This forecast includes $43 million of additional net interest expense anticipated from the $2 billion in senior notes issued during September as well as the expected impact of share repurchases in FY16, which are assumed to be completed ratably over the next 24 months. Together, these items are not anticipated to have a material impact on our diluted earnings per share for the year. The forecast does not contemplate further share buybacks beyond anticipated future dilution related to employee benefit plans, although it is our intention to return excess cash to shareholders depending on market conditions.

And as Carlos mentioned, we have a lot of work in front of us, particularly in the second quarter as we install new solutions and prepare to support our clients in their efforts to comply with ACA. We have on-boarded more than 500 associates through the first quarter and engaged third parties to assist with our implementation efforts, but the majority of this expanse will ramp in the second quarter. This investment, combined with lower anticipated revenue growth continuing into the second quarter from the effects of foreign currency, is expected to result in EBIT that is flat compared to last year's second quarter.

We believe the adjustments we have made to our FY16 forecast reflect the challenges and opportunities that we have in front of us. But we also acknowledge that changing factors such as higher than anticipated new business bookings or higher client call volumes related to ACA could put a short-term strain on our earnings growth.

There are many factors at play in the market and with our clients which could cause risk in achieving our full-year earnings forecast. However, we believe that delivering on commitments to our clients and focusing on our strategy will yield the best long-term results for ADP.

So with that, I will turn it over to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

David Togut, Evercore ISI.

Anthony Cyganovich - *Evercore ISI - Analyst*

Hi, this is Anthony Cyganovich on for David. How do you think about balancing in the above trend growth in global new business bookings with the expense associated with implementation?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I'm sorry, the question's related to global -- you mean to bookings outside of the US?

Anthony Cyganovich - *Evercore ISI - Analyst*

No, overall bookings.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I think for decades we've always taken the position that we'll take as much business as we can get from a bookings standpoint. So when you look at the lifetime value and the present value of discounted cash flows of our clients, given our retention rates especially in the mid-market and the up-market, we basically have to take all the business as we can. So we have always been willing to sacrifice short-term profitability in the form of additional implementation and service expense in order to add additional and implement new additional bookings and raise our revenue growth.

And that's really what has been happening over the last three or four years. We clearly have had greater tailwinds in the last few quarters than we have seen for a while.

I want to remind everyone we've had double-digit sales growth on a compounded basis here now for four years. That's what's really helped create this, in our world, accelerating revenue growth which is in 0.5 point to 1 point increments at a time per year. So our revenue growth has kind of slowly inched up.

When you look at it on a constant-dollar basis, 9% growth for the quarter, and we believe that in the second half of the year we might be higher than that because our guidance is very clear that we expect to be above the guidance range. Those are pretty strong revenue growth numbers for ADP, and it's driven by new business bookings that we've been able to generate over all these years. And now we're in a situation where we have even stronger new business bookings and we're going to continue to do the same thing, which is we're going to take it all and we're going to implement it all.

Anthony Cyganovich - *Evercore ISI - Analyst*

Thanks, that's helpful. Just a follow-up, can you talk about the pipeline of new products you intend to introduce in employer services and PEO over the next one to three years?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

This probably is not the best forum to do that. From a competitive standpoint, think the things that I talked about in my introductory statements I think probably give you a sense of in some of the direction that we're headed in, which is really providing a lot more insight through data analytics for our clients in order to help them run their businesses better, hire the right people, retain the people, pay them the right amounts. And there's all very, very powerful insights that can be gleaned from the data that ADP has.

I think we've known that this is a competitive advantage for us in a differentiator. We spent the last two or three years really building the products and I think DataCloud and analytics that we're building on that platform, I think are going to provide those types of tools for our clients.

So we are working on a few other things that we're really not ready to talk about just yet. But if you look at our balance sheet and you look at our P&L and you look at our statements, I think you will be able to glean from them that we are investing a lot in R&D and in product development.

Anthony Cyganovich - *Evercore ISI - Analyst*

Great, thanks a lot.

Operator

S.K. Prasad Borra, Goldman Sachs.

S.K. Prasad Borra - *Goldman Sachs - Analyst*

Thanks for taking my question. Carlos, could you provide some color on the specific products and services which are driving this new bookings growth? And is it last year driven by ACA? Or would you say that some of your new platforms, whether is Vantage or RUN that are also seeing some increased traction?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I think it's a combination of both. I think that we are selling some stand-alone ACA solutions in our up-market space, but most of our ACA new bookings and sales are associated with either existing clients or new clients that have our broader HCM solution. So it's probably safe to say that the ACA sales are being pulled by our HCM solutions and some of our HCM solution sales are being pulled by ACA. So it's probably a combination of the two.

Just to reiterate what we said in the fourth quarter and for the year, we had really across-the-board strong new business bookings in all of our segments and all of our strategic platforms without ACA included. In the first quarter we came off of a very, very strong fourth-quarter sales. And I think we've, again, for several years have been talking about how the way our incentives work from a sales standpoint, that it's somewhat difficult to maintain the momentum into the first quarter when you have such a strong finish. Yet we were able to do that and I think it's safe to say, given the way Jan described it in his comments, that ACA helped with that.

Under normal circumstances you probably would've expected in the first quarter we would've expected by historical standards, mid to low single-digit new bookings growth without the extraordinary tailwinds that we got from the ACA. And I think that's probably gives you a general gist of our comments. But we are actually in the context of what we know about how ADP behaves and how our sales force behaves and the incentive drive things, we're very pleased with our first-quarter new bookings growth, excluding ACA and including ACA.

S.K. Prasad Borra - *Goldman Sachs - Analyst*

Okay, and just a follow-up. How should one think about the profitability of the increased sales related to ACA? Is it a combination of the PEO business, below margin PEO business primarily? Or would you say that some of the more profitable segments like time and attendance and other solutions are also benefiting from this?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Keep in mind we're selling the ACA solutions as a bundle and so assigning profitability is always a little bit tricky. But our business cases and our plan is to have the margins of the ACA modules to be right in line with our other good functioning products that you mentioned.

So I would not see any meaningful impact on our overall margin characteristics from them other than they are right now growing and have to carry, of course, implementation and sales costs. But the ongoing, if you like, contributing margin of these products is right in line with what we have in our product portfolio.

S.K. Prasad Borra - *Goldman Sachs - Analyst*

Okay, thanks, Carlos.

Operator

Thank you. Sara Gubins, BofA Merrill Lynch.

Brent Navon - *BofA Merrill Lynch - Analyst*

Hi, this is Brent Navon calling in for Sara. Follow-up on strong new bookings, is there any way you can break out how much was driven by the ACA compliance versus non-ACA related work?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

We don't really break out in detail the product components that we have. It was a contributor to the 13%, but as Carlos said, on a typical quarter our internal plans were calling -- we would expect after a strong fourth quarter mid to high single-digit sales growth in the first quarter, and we really accelerated across the board. So that's what we'll say.

So it's not the majority of our sales growth, quite the opposite actually. Our core strategic platform sold well and had nice growth rates in the quarter. Multi-nationals had great success stories this quarter. So it was a broad-based acceleration of new business bookings and ACA had a trigger event to that.

So it's hard to separate it all so analytically because people that buy ACA also by HCM solutions in order to make it all work. It is kind of a combination and not -- I think that's kind of honestly what we can probably really mostly analytically give you.

Brent Navon - *BofA Merrill Lynch - Analyst*

Okay thanks. And then just as a follow-up, does your guidance contemplate retention improving significantly for the rest of the year?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

The retention, as a quarterly measure, fluctuates. Carlos gave detailed comments on the retention development. We also would like to mention in the first quarter prior year we had a large improvement, significant improvement, in the quarter so there was probably some catch-up in this quarter and a difficult compare. Overall I think we don't guide to retention, but I think that will be a mistake to think retention would continue at these levels.

Brent Navon - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Operator

Gary Bisbee of RBC.

Gary Bisbee - *RBC Capital Markets - Analyst*

Hi, just following up on that question of retention. So Carlos, it sounded like in your commentary there was some either staffing issues or execution issues from the client service perspective. I wanted to understand, on the margin commentary for the Company overall, is that basically just the on-boarding costs and sales commissions from the stronger bookings? Or is there also a component of we need to fix something here to get this retention back on track? Specifically what type of costs would those be? Thanks.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

That's a very astute observation and I would say that we did feel some pressure in certain areas of our business. But frankly, we have other parts of our business where retention improved and margins are up and all is good. As usual, it's a portfolio and we have different situations in different parts of the business in the Company.

But the one thing that is absolutely clear, again, decades and decades of experience, is that despite our desire to upgrade and migrate our clients to our newest and best platforms, this retention figure is very, very important to us. We're very fortunate that we have very, very strong new business bookings which is offsetting some of the retention weakness that we have.

But generally speaking, that puts pressure on us because obviously those -- even if we achieve the same revenue growth or even accelerate our revenue growth, it comes with pressure on margin because you have implementation costs and sales costs. We've been very, very clear about our desire to accelerate migrations and we did that; we maybe did it a little too effectively.

So I think we've created some pressure in the system as a result of a significant increase in migrations year over year. At the same time, when we were experiencing, frankly I would describe it as a -- not to overstate it -- but we were surprised by the volume of sales that we've gotten as a result in some part, as a result of ACA compliance solution demand.

So we have this combination of all this volume that's coming in, while at the same time we were creating pressure in our implementation and service organization around migrations. I think we took a pause and recognized that this is the right time to make sure that we are still pushing -- we're not backing off from migrations. We have a lot of data that we've looked at very, very carefully over the last two or three weeks that shows that retention on a new strategic platforms is very, very high and is remaining at very high levels.

Because we have the ability to compare our retention by platform, but also over time. And we're very, very confident that our long-term strategy of moving these clients is the right strategy and it will end up creating the same outcome that we now have in our SBS business. But you see the impact of what happened in the quarter when you push a little too hard and you have other moving parts and other variables like ACA and overall strong bookings across the board.

So I think your observations are correct; they are astute. And we are doing whatever we can to stabilize here and make sure that we deliver on these commitments that we've made to our clients on these new business bookings regarding ACA, at the same time, delivering our commitments to our existing clients who deserve to have the right level of service from our service organization.

And so I think what you're seeing from the margin, I think the last part of your question was really around margin. We have added, I would say, somewhere between 500 and 1,000 people just during probably the beginning, before the first quarter. On an effective basis we have this cost already in our quarter. And I think Jan was clear about that, that as of today based on what we know today and the bookings growth that we have experienced so far, we believe that we have the proper expense in the plan to handle the stabilization of our new starts for ACA, as well as the needs to stabilize our service organization to handle the combination of the new volume as well as the migrations.

Obviously if we were to experience additional incremental above what we've guided new starts, we would have to come back and revisit. But as of today we're very, very comfortable that we have addressed the issue. And you can see that we still have pretty good margin results despite what is, frankly, quite a large investment that we've put back into the business. I think that speaks to some of the underlying improvement and good execution that we've had for several years around margin and expense control that allows us to ramp up expenses for this level and still deliver what I believe are very respectable results that are still something to be proud of.

Gary Bisbee - *RBC Capital Markets - Analyst*

Thank you, I appreciate the commentary.

Operator

David Grossman, Stifel Financial.

David Grossman - *Stifel Nicolaus - Analyst*

Great, thank you. Sorry, just a follow-up on that last question then. If you look at the business then and you're looking at the retention rate, it sounds like you feel that the core issue is really one of implementation capacity versus competitive losses that come with the churn, if you will, or exposure that comes with the platform upgrade.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I think I said it's both. Because we can see our retention rates by platform, we know where we have exposure and we have weakness. Of course we've known that for years, which is why we're doing what we're doing, because that is really, I think, ADP's vulnerability, which there's plenty of. There's plenty of competition out there.

I think that has been a vulnerability that we, over last three or four years, have opted to try to close. I think I've used the analogy of making sure that people are fishing in a smaller and smaller pond. When we create activity around migrations, particularly in the mid-market and the up-market, a lot of fishermen come even to a smaller pond.

I think we've experienced that, some of that, over the quarter. But I also want to be clear that I, in my previous answer, that in addition to that, the overall increase in activity in volume has put strain on our implementation and service organization. They have done an incredible job over the last two or three months to get a lot of this business that has been sold in the fourth quarter, started. And they're doing that and they're doing a tremendous job. But they are working very, very hard and they're under tremendous strain, which is why we've added additional resources to help them.

David Grossman - *Stifel Nicolaus - Analyst*

Okay. And to follow it up then, Jan's comment about not to assume that retention would stay at these levels. Is that contemplating the increased capacity that you put in would help alleviate some of the stress on the system that you're experiencing in the current quarter?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, I think what you see is that the incremental resources are already doing their thing. So we see already these improvements coming through. Yes, we obviously work very hard to retain every client that we can. I gave you the typical compares to the other factors in it. We do not give guidance to revenue retention, but it would certainly be not our expectation to stay at this level.

David Grossman - *Stifel Nicolaus - Analyst*

Very good, thank you.

Operator

Smitti Strethapramote, Morgan Stanley.

Daniel Hussein - *Morgan Stanley - Analyst*

Hi, Carlos and Jan, this is Daniel Hussein calling in for Smitti. Just wanted to pry a little bit more into the retention.

I appreciate you gave a good amount of color already, but could you provide a little bit more detail about which channels saw the most attrition? I know you guys look closely at where your customers are going. So did any competitor or type of competitor stand out? Or was it just the usual suspects?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

It really is as usual. I wish we had more exciting news to tell you because it would be easier for us if it were one competitor. Theoretically it would be easier. But it is really not that kind of story.

By the way, it fluctuates also from quarter to quarter, so we unfortunately don't have any news to report on that front. We don't have any specific competitor that is doing a lot better or lot worse than last year, and likewise the same in the other direction. We just have a very, very broad group of competitors. Remember, we compete against some competitors in the up-market which are different from the ones we compete in the mid-market which are different from the ones we compete in the low end of the market.

But again, just to add, we have to be careful in terms of we're not trying to help our competitors here on these calls. But I think we've given you a lot of information already, so when we say that we experienced a great deal of pressure and turnover as a result of migrations, and we tell you last quarter that we're done with our RUN migrations in the low end of the business, you could probably jump to the conclusion that we didn't have a retention problem in SBS, or that maybe it even improved. But we wouldn't be able to tell you that because we don't provide guidance by business unit.

I think Jan also mentioned that once you get into the up-market and the mid-market, the comparisons do matter. We have a difficult compare versus last year's first quarter. But we're also trying to be transparent and share with you the information that we're seeing, which is this churn in our legacy base combined with what was enormous pressure on our service and implementation organization as a result of a large surge in business that we, I think with the benefit of hindsight, needed to have had additional resources to handle. And we have this resources now place.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Maybe one last comment is, as you saw, we really left our revenue guidance intact, left it intact for employer services and just down-ticked it for the divestiture of our AdvancedMD business, which tells you also that we are confident about achieving the revenue number in the framework that we're guiding to, which contemplates of course, client retention in the revenue model.

Daniel Hussein - *Morgan Stanley - Analyst*

Got it, thanks. And then a quick question on the debt issue. At this point would you characterize $2 billion as testing the waters? Or is this, at this point, what you think your capital structure should look like?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes so we affirmed at our Investor Day and also during our debt IPO that we're committed to our AA rating, and solidly in it. As you know, we have requirements that in our money movement and client fund operation that make a strong, exceptionally strong, credit rating very helpful. So you should think of this as a one and done deal of $2 billion debt on our balance sheet.

Daniel Hussein - *Morgan Stanley - Analyst*

Great, thank you.

Operator

Lisa Ellis, Bernstein.

Lisa Ellis - *Sanford C. Bernstein & Co. - Analyst*

Hi, good morning, guys. Can you give an idea of, given the dates associated with the ACA regulation, how long, like what you're anticipating the elevated bookings outlook to look like? Like how this will play out over the next four, six, eight quarters?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

This is all going to be somewhat speculative because we've never been through an ACA -- as you know, this is a new law and it's complex and it's been phased in over time and now there are some real teeth, if you will, and real penalties and real requirements with forms and so forth that kick in on January 1. But we've never seen this before, and so it's hard to imagine.

But some of the things that we're looking at, as an example, is what percentage of our client base has purchased or taken has the ACA solutions that we are selling and the answer is it's less than half, significantly less than half. So there probably is some additional upside and I think there's two scenarios.

One is on January 1 everyone stops worrying about ACA and our new bookings return to our normal levels of 8% to 10%, or somewhere in that range. The other scenario is that come January 1 or January 30 or the end of February, people worry more about ACA because all of a sudden the reality has hit. That continues to drive demand for our solutions but also the solutions of some of our competitors and other people out there.

The truth is probably somewhere in the middle. It's hard to believe that there will be no additional interest or demand for ACA compliance or HCM solutions that help with ACA compliance post January 1. But we really would literally be speculating and guessing as to what those levels would be.

And you just saw what happened over the last six months, which is that we underestimated and under-guessed the level of activity and demand for these products. In theory we should have known better. Now we're going to be probably a little bit more vigilant and make sure that we are prepared if we have continued demand at the levels that we're seeing today.

Lisa Ellis - *Sanford C. Bernstein & Co. - Analyst*

Terrific. And then on the follow-up can you give us a little bit of a temperature check on the PEO business, which continues to churn along very strongly? Is primarily what you're seeing there still greenfield sales? Or are you benefiting from some of the struggles of some of your competitors in that area?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, traditionally ADP's PEO has grown from two sources: leads from our own client base and greenfield clients. And the mix of that has been balanced and it continues to be very balanced. The execution in the PEO is extremely solid and it's a very competitive product.

So I think we're seeing just a continuation of the trend, nothing specifically to report relative to the competitive environment. We have been the market leader with a superior product for a very long time in execution, and I think we're benefiting from that strength and continue to do so.

Lisa Ellis - *Sanford C. Bernstein & Co. - Analyst*

Terrific, thanks, guys.

Operator

Jason Kupferberg, Jefferies.

Ryan Cary - *Jefferies & Company - Analyst*

Good morning, this is Ryan Cary calling in for Jason. Thanks for taking my questions.

Just a quick question on pays per control. I know you reiterated the full-year expectations of 2% to 3%. There seems like the 2%, 2.5% in the quarter is a little bit lower than we've seen in some time. Anything to read into there or does it just bounce around quarter to quarter?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

I think what we're seeing is a little bit of a maturing in the growth in the labor market. In our case I think we're right in the middle of what we expected. So it has to do with the hiring situation of some of our clients; I think manufacturing and energy slowed a little bit.

So I wouldn't read too much into it; I think this is more a general comment about what is the assessment about the overall economic growth in the labor market to be done. And I think we had for many, many years a strong labor market and it seems to be now a little bit maturing. Still at a very good clip, so I'm not too worried about it. I think it's right in line of where we thought it would be.

Ryan Cary - *Jefferies & Company - Analyst*

Okay, great. I wanted to touch on pricing with my second question. First could you talk about some of the trends you are seeing in the quarter? And then when looking at the continued strong new business bookings we've seen over the last several quarters, do you see pricing as a driver for any of these new deal wins?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, so in pricing I think we have to analytically always separate what's happening in pricing and our base and what is happening in pricing on our new deals. I think with your question you're targeting a little bit what is the pricing environment for new deals.

We monitor that very carefully and measure it as our relative discounting levels that we have in the business. They do fluctuate as we also exercise different sales strategies in different markets, but the overall mix and discounting level stays the same.

So we do see a stable competitive environment relative to pricing. Relative to our base, we continue to execute a strategy that targets less than 8% of price increase in our base, which is consistent of what we communicated with you in our Investor Day earlier in spring. And we're executing exactly along our plans.

Ryan Cary - *Jefferies & Company - Analyst*

Great, thanks for taking my questions.

Operator

Jim Macdonald, First Analysis.

Jim Macdonald - *First Analysis Securities - Analyst*

Good morning, guys. I wanted to follow up on Carlos's point about migrations being done for small business. Could you talk about how many migrations are left in the other businesses that could impact retention?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I think in the guidance we've given in the past, or I wouldn't call it formal guidance, but we've been talking about trying to complete our migrations in our mid-market by the end of FY17. And we are still on track to do that, and that will have all of our clients on our current version of Workforce Now. We've made really tremendous progress over the last year.

We talked about in the last call that we had put in incremental resources to accelerate migrations. And we did that very effectively, which as I mentioned, also happened to put some pressure on us execution-wise. But we've really made great progress.

There was a platform in the mid-market called PCPW, which we are now down to, I think, it's 100 clients or less. So it a very big accomplishment because that was a fairly large base in our mid-market space. We're methodically -- we're going through the same process that we went through in our small business division.

I think as someone reminded me just a few days ago, the process in SBS of first stopping sales on the older platforms and then beginning the process of migration took a total of 5 years to 6 years. These are not overnight. This is a recurring revenue model. We value client retention and we value our clients. We do have to get off of these platforms but we will not do it on anybody's timeline other than our own timeline, when it's the right time under the right circumstances.

I think we have a good plan that we've been executing in our mid-market and we're, I think, on track on that plan. In the up-market we've said multiple times that it's a bigger challenge given the size of the clients and the complexity, and frankly, the number of platforms we have. But I think there too we have taken steps and built into this year's plan a good number of migrations over to our Vantage platform.

We are starting to execute on some of that and whereas a couple of years ago we had literally no migrations on Vantage. So then maybe we had a couple a year. We have -- I'm not going to disclose exactly the number -- but we have some number of migrations. By the way, these are all pull migrations for now where the clients are lining up and want to be upgraded to Vantage, so this is not a push or a forced migration at this point. I think it's safe to say we're on track in terms of our plans in up-market as well.

Jim Macdonald - *First Analysis Securities - Analyst*

Great. Then as a follow-up, I hear you settled your spat with Zenefits, but did that have any impact in the quarter, or distraction?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

It had a lot of distraction, no impact.

Jim Macdonald - *First Analysis Securities - Analyst*

Okay.

Operator

Tien-tsin Huang, JPMorgan.

Tien-tsin Huang - *JPMorgan - Analyst*

Great, thanks. It's always for the details. Just one question for me also on price, but I'll ask it a different way. In terms of playing defense, I get that you're more disciplined on pricing general, but did you have potential to pull the pricing lever to protect your book from leaving as part of some of these migrations and you chose not to? Just curious what your tactic there was to try and actually protect that book as they transition?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I think it's a fair question. I think that the truth is that this was not a pricing issue.

Tien-tsin Huang - *JPMorgan - Analyst*

It sounds like you don't want to elaborate on that?

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I'm sorry. What was the rest of the question?

Tien-tsin Huang - *JPMorgan - Analyst*

I guess if it's not pricing, was it a change in desire to move to a different platform? Or to use a new service provider? I'm just trying to better understand that.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

I tend to choke on my words when I confess that we had execution challenges. If you just let me off the hook.

Tien-tsin Huang - *JPMorgan - Analyst*

Okay, fair enough, I'm good. Makes sense, thanks, guys.

Sara Grilliot - *Automatic Data Processing Inc - VP of IR*

We have time for one more question.

Operator

Rick Eskelsen, Wells Fargo.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Good morning, thank you for squeezing me in here. Carlos, I wondered if we could go back and talk about analytics? You talked about that in your upfront commentary.

Just wondering how you guys are pricing it and viewing it for clients? How much is built in versus being sold separately to clients? Is it something that helps you win a deal or is it something that you're looking to actively monetize here?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

I'll answer on the pricing side. We have a number of modules that are incremental to our core HCM products, as you buy payroll obviously and time and attendance benefits and others, we have employee per month charges. And incremental products like analytics is charged on an incremental basis also. And it comes in different flavors depending on how comprehensive you want to subscribe to the benefit and to the benchmarking and deep analytics services.

So, yes, the short answer is it is an incremental per employee per month charge and we're planning to monetize it for the vast amount of our business.

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

And everything we do is to help us win more business. So I think the last part of you question, clearly we do think that it helps differentiate us and helps us win deals.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Thank you, then just a quick follow-up. With your switch now to EBIT margins, are you going to be talking about the segments more in EBIT or still on a pretax basis? Thank you.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

It's kind of the same really, there's no difference. We call it now segment margins, but those obviously do not include -- and PEO don't include any interest charges from the long-term debt. So they are really unchanged.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Thank you.

Operator

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

Carlos Rodriguez - *Automatic Data Processing Inc - President and CEO*

Thank you all joining us today. As you could probably tell from our tone, we're really excited about the strong start that we had to the year. And we're really happy with our momentum, especially in our new business bookings. You also probably heard our tone that we definitely feel like we have some challenge in front of us in terms of implementing all this new business so that we really deliver on our commitments to our clients to help them comply with the new and complex healthcare regulations.

But I think I also want to take this time to really thank all of our associates from sales, implementation and service for all the hard work they've done. It's been a very challenging six months, and particularly a challenging quarter in term of workloads. We appreciate everything they're doing and they're going to continue to do to build upon ADP's past successes.

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. Have a great rest of your day.
