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ADP - Automatic Data Processing Inc at Nasdaq OMX Investor Program

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CORPORATE PARTICIPANTS

Jan Siegmund *Automatic Data Processing, Inc. - CFO*

PRESENTATION

Unidentified Participant

We're going to start our afternoon track with ADP. For those of you who don't know, powerful technology plus a human touch. Companies of all types and sizes around the world rely on ADP's Cloud software and expert insight to help unlock the potential of their people, HR, talent, benefits, payroll, and compliance, including NASDAQ, who is a proud client. And they are working together to build a better workforce.

Joining us this afternoon is Jan Siegmund, Chief Financial Officer. So I will pass it over to you, Jan.

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

I appreciate your time and your interest in ADP. And I will try to make the very best of this hour after lunch, which we'll put extra energy and effort into offering you hopefully the most interesting components of what ADP has been doing, the core elements of our strategy.

But for those of you who are not so familiar with ADP as an investment story, I'll start with introducing the Company in a few slides to you before we dive into the detail. I hope we have room for questions at the end of the session, so I will try to control my prepared remarks to 20 minutes and offer you some room to pepper me with good questions.

So, ADP, many of you will think of us at first sight as a large payroll provider, but we have used the last decade to our advantage and transformed ourselves into the leader of global human capital management solutions. So far beyond payroll, we have developed strong capabilities across the board of all HR solutions that are listed here.

Still, our proud core is our strength in payroll and global payroll. We have a particularly strong market position in the US where we pay one in six employees. And the payroll business had been the foundation for our current success and strength in the integrated human capital management market.

We serve 630,000 clients, many of them in the small space, but good market share also, all the way from the smallest proprietary with one employee to the largest corporations on this globe with about 55,000 employees in 40 countries present.

Our global presence in so many countries offers a distinct advantage for us to compete because it is by far the most comprehensive global exposure that you can get if you're interested in acquiring a global payroll solution.

We have our traditional strength in compliance solutions and that strength has developed through our exposure to money movement and tax filing operations that are attached to our payroll business, and you see some impressive statistics on the third column here and our chart moving a lot of money, in particular in the US and Canada, but now also starting in Europe and generating large client fund balances of approximately \$22 billion, on average, an important source of income and revenue for ADP as we invest those client funds on a consistent basis in generating client fund income.

We have a proud history of very consistent performance. We are a 41-year history of dividend increases, history that we value and we are working hard to continue in the future, and are an \$11 billion Company that is entirely focused on human capital management.

And our performance that I'll illustrate here is something that we're proud of. As you can see here illustrated on the left-hand side of my chart is consistent revenue growth that has been accelerating fiscal-year 2015. Our revenue growth of 7% was impacted by approximately 2% on FX pressure that US firms experienced and so did we. We were able to continually expand our operating margins, overcome some of the margin



pressure that the low interest rate environment has created for us, and driving organic revenue growth in combination with consistent margin expansion.

We have augmented our returns to our shareholders by buying back consistently shares and returning excess cash to our shareholders and it has paid a handsome dividend over time that created a dividend yield of approximately 2.5%. So from a total shareholder return perspective, respectable results in the last five years. We performed in the top quartile of the S&P 500.

So when you think about ADP, it is a consistent mid single-digit revenue grower and we aim to continue on this track of consistent margin expansion and solid dividend yields to deliver a very balanced total shareholder return. That is the core of our committed strategy. And I will illustrate how we're planning to do it.

One of the strengths that ADP offers and has put a lot of energy in is to be focused on human capital management. Many years ago, we had a variety of transaction processing businesses attached to the ADP name, but with the completion of a tax-free spin to our shareholders of CDK Global, September a year ago, we are now a pure HCM player and we offer really a broad scope of solutions from recruiting solutions to retirement solutions. If it is in the HR space, likely that ADP has a solution for it.

One of the characteristics of how we like to compete is with the broad scope of integrated services that we offer. And we are offering these services on our value proposition in a combination of a strong technology platform. We, as many in the industry, are focusing on our SaaS solutions. The HR services industry and technology industry has undergone the same transitions that other industries have gone and SaaS is the name of the game, and ADP is proud to be the largest B2B SaaS provider in the world. And pair this with our historic strength of a proven support model, strength in compliance, and HR outsourced solutions for a comprehensive value proposition to our clients.

So it is not a pure software play that ADP is following, but it is an integrated service, compliance, and technology solution that we aim to deliver to our clients.

What makes us good here is our -- here's my value proposition to you. We have demonstrated over many years a consistent ability to drive a strong recurring revenue model that is paired with consistent margin and earnings expansion, and one of the benefits of our business model is that we are able to deliver those results with low capital requirements and hence have strong cash flow at our operations, and that allows us, A, to invest into the future and I will talk little bit about our strategy to drive this consistent success for many years to come, but also to deliver a very consistent payback to our shareholders for 41 years of consecutive dividend increases and a long commitment to shareholder-friendly actions.

Our balance sheet is the strongest in the HCM industry. We enjoy a AA credit rating and raised recently \$2 billion of debt in order to give it back to our shareholders over the next two years.

How do we do it? Our strategy is described by really three growth areas and I will substantiate the strategy with a few revenue numbers following later in the presentation. The core are our suite of HCM solutions that we offer to all client sizes across the globe and will want to grow, of course, our market penetration with HCM solutions. That means gaining new clients. That means selling our existing clients broader HCM solutions.

ADP's client growth last year was approximately 4%, and the year before, closer to 5%. So we have enjoyed a continuous increase in absolute number of clients that have enjoyed ADP services, but we also were successful in selling more of our payroll clients into more comprehensive HCM solutions.

As I mentioned, ADP is not only about the core classic value proposition of ADP based on our core technologies, but we also have been increasingly successful in selling our clients and convincing our clients to purchase our HR BPO solutions. We report this separately. For one, our biggest HR BPO solutions is the PEO services and it's a great example for our success in offering, based on our core technology platforms, incremental outsourcing services to our clients and it contributes a nice amount of revenues to our overall growth.

And finally, we are leveraging our global presence with actual in-country ADP presence of 40 countries and ability to offer processing and HR solutions in more than 100 countries today with a very differentiated global solutions.



Those three big growth drivers are responsible for the overall long-term growth aspiration that we have to grow our revenues between 7% and 9%.

We have engaged throughout the last four years in a significant strategic shift in focus. It has focus and started, really, with a focus on innovation. We accelerated our spend in R&D; we accelerated our movement to core strategic SaaS platforms in the last three years and innovating across the product, client, and distribution experience on all levels.

And we pair that innovation shift with a significant focus on simplifying our own operation. We are migrating our clients from our classic or legacy platforms, if you will, to our newer platforms and have concerted efforts to continue to reduce the complexity of our own operation in order to have more clients utilize our latest versions of our products and offer our clients really the most streamlined and best experience that they can expect from us.

So that combination of reducing complexity while focusing on innovative and new technologies and new client experiences is the essence of what we have been working on for the last three or four years as we have adopted our strategy. And as a consequence, we are expecting a balanced growth profile for the future.

In our analyst day last April, we offered this longer-term view about our annual organic revenue growth plan, and you can see the sources of the revenue growth listed here in this chart. The core is our HCM solutions. That is the foundation of everything, but then upselling our clients to and encouraging our clients to utilize our fully outsourced HR BPO solution has been an important and lately a very successful strategy for us.

And our multinational solutions is a differentiated market-leading offering that has offered great growth opportunities for our multinational office solution. It all results into that 7% to 9% annual revenue growth that we are currently, if you adjust for our FX pressure that we are experiencing in our business, achieving, actually closer to the upper end of that revenue growth where ADP is today.

So, we are a market leader and you should think of while we are focused on HCM, we are a diversified company because we compete in so many markets. We have the broadest market coverage relative to geography compared to any of our competitors and we have -- we serve really all client sizes, which offers us a variety of growth opportunities. And you can see here we think that as to differentiation and long-term sustainability of our growth path, it is not that we are a pure software player, but we are believing in our integrated value proposition. We don't have just single best-of-breed solutions, but a full suite of integrated products, and so forth, we think this is a winning combination for the years to come.

The markets are large and growing. Industry analysts, and I think there's fair consensus around this, think that global markets are going to be growing roughly at twice the rate of GDP, and we have a market share below 10%, so ample of room to grow for us and to gain share over time. As you can see, we in the US, as an example here, aim to grow our client base. We didn't quite achieve the 5%, but 4% of client growth in the last year. On average, you see here of about 5% for the last three years. We have been gaining share over time and good proof for the success of our overall growth strategy.

Our HCM portfolio on the newest platform -- these are our core strategic platforms; these are Cloud-based SaaS platforms that we are competing today -- is impressive. We have more than 440,000 clients in the small market segment and our run platform has been a big success for the last four or five years, really growing our client count very nicely in the down market.

The midmarket, we are a clear market leader with more than 60,000 clients on Workforce Now, which is our integrated, comprehensive HCM platform in the midmarket. And our newest platform, just released approximately two years ago, is Vantage with now more than 200 clients sold and client size of approximately 4,000.

And we talked about global HCM market with fewer very large clients on the multinational solution, but a large number of employees serviced through the multinational solutions.

As you saw and I bragged already earlier, too, we have a large number of clients in the Cloud now and had early luck or early good intuition of investing into mobile technologies. Today, almost 6 million employees are using a feature-rich mobile functionality and we're developing, really,



our solutions for the virtual employee today and have made -- have a market-leading position in the number of users clearly, but also are setting new standards of how we can operate HR solutions in the mobile space.

And as a consequence, our measure of sales success are our new business bookings. We define new business bookings as the estimated annualized recurring revenue that our sales force distributes. So this is an incremental recurring revenue number that we add every year to our recurring revenue base, and we achieved increasing sales success with one of the largest B2B sales forces that there exists. 6,000 quota carriers have sold more than \$1.6 billion of recurring revenue just last fiscal year, and for the last three years, we achieved a 10% CAGR, which is quite an accomplishment we are proud of as a Company for -- as a success and proof of our -- that the strategic direction that we have taken is the right one.

We believe in global solutions. I mentioned this, 20 languages, but that doesn't define capability. I think the expertise of a global compliance team, the knowledge of how to run a variety of country-specific solutions is really what sets us apart and has been an interesting and important contributor to our global differentiation.

We have been expanding globally hence and ADP is now a global company. We are doing business in many countries. We are listing just a few here, with specific focus of moving a lot of our operation and service elements to cost-advantaged location mainly in the Philippines and India, some in Eastern Europe as well, and planning to continue this expansion in the years to come.

The complex regulatory environment has been a friend for ADP. We are smiling when Washington in the US cooks up new ideas for employers, although, of course, we regret the burden that it creates for business. But, obviously, part of our business model is to help our clients to be in compliance and we have -- and that has been a tremendous benefit for us, namely the Affordable Care Act, which is the healthcare reform that is in the midst of implementation and ADP had developed very comprehensive answers to put clients into compliance with this massive regulatory change.

But it is just one example of a continuous stream of regulatory burdens that clients face. And we have been there for our clients to relieve them from those burden. Compliance is an important factor; it's something that we do well and that we get recognized for.

That is not only a US-specific development. I'm listing here a few. Across the world, the HR departments are challenged by regulatory change across the board for many, in particular in France and the UK. You see here in Brazil many wide changes have driven the demand for our solutions over the last few years.

As I look forward, what are we betting on? You will not be surprised to hear that ADP also believes to have an advantage in big data. We are blessed with a very large employee base and hence a very large database. Not only the size of the 23 million employee records that are currently in our systems, but also the quality of the HR data being rooted in a payroll system which has traditionally the highest quality of data in the HR space has given us a great leg up. We've worked hard in the last few years to make this data usable and started marketing our data analytics solutions in the market in the last six to nine months and seen already a great demand for it.

One of the most obvious solutions that we have been developing are benchmarks, and so you have no unparallel as a client of ADP unparalleled access to really game-changing information for an HR department. Right when you want to make an offer and you are looking for the right salary analysis for a company of your size for a job of the category that you're hiring, you can get regional-specific real-time data, not survey data, out of our systems.

When you want to know what type of benefit contribution should a company make because healthcare environment is changing -- should I make more employee contributions, should I have a different plan offering, we can offer you the benchmark and you can do better, more insightful decisions in the HR space.

But it goes even further. This data will flow and is flowing into our applications, so when you are doing employee development plans, we have a wonderful predictive analytics that predicts your likelihood to leave the company, the flight risk statistic, and we can give the five reasons why you may be more or less likely to leave the company based on statistical analysis, but behavior of 23 million associates.



So it will over time make our applications so much more insightful and create what we hope a lasting differentiator in the HCM space.

So, big hope and big investment as a CFO, I say, into big data and hopefully it will pay off.

I mentioned TotalSource in the beginning. It is a US-specific solution, so I want to spend one or two minutes on it because it is a separate reporting segment for ADP. It has been growing very nicely if you look at our numbers and it is a comprehensive outsourcing solution in which we offer to midsize companies. The average company size, employee size, is about 40 employees for a total -- typical TotalSource client, and what we do is we offer really a full package of HR solutions plus healthcare, plus workers' compensation, insurance, plus other insurance types. So it's an integrated and full outsourcing model in which ADP as a US technicality becomes the co-employer of that employee, and so we take wide-reaching responsibilities in this model.

This model has faced very good market demands, partially because of the Affordable Care Act because you are compliant when you sign up for it and that has driven certainly incremental demand in the past few years. But we also have the benefit of ADP's large scale. We have 6,000 quota carriers who are helping us to find the appropriate leads for the ADP TotalSource business unit and that allows us to be very prudent in the underwriting and risk selection for our clients. And as a consequence, we have built a very beautiful book of business that performs very well, in particular relative to the underwriting of those things.

It's worth mentioning that ADP does not take any meaningful insurance risk in this model. We are fully insured on our healthcare side and we are virtually fully insured and reinsured on the workers' compensation side. So as a consequence, we have really a very smooth performance of the growth in this business. So an important component, but think of it as a great example of a fully outsourced HR BPO solution that we also offer for other client segments that are really reported in our employer services segment. So, a good business to have and a good performance.

So how do we use our cash that we are generating with this growth? As you might expect, we are excited about our own business and to invest into our own organic revenue growth, and we have accelerated our R&D investment, for example, in the last few years to grow roughly in line with revenues. We have done acquisitions, a little bit fewer in the last couple of years as we have engaged in kind of a more organic R&D investment strategy, if you like. But in the future, geographic expansion might be an area where we would continue to invest.

And then, we are committed to returning that cash to our shareholders on a very consistent basis, and some of these things I mentioned. We are targeting a 55% to 60% payout ratio for all our dividends. We're currently a little bit higher due to an impact that the tax-free spin or CDK Global had in returning excess cash on a flexible basis to our shareholders on a very consistent basis.

And I mentioned our \$2 billion debt issuance that optimized and enhanced our capital structure, and we'll be offering additional monies through share repurchases back to our shareholders in the next 12 to 24 months.

I'm rushing here a little bit. So when you think about our revenue structure, our sales success, new business bookings, it's the most important contributor for our long-term organic growth. Maintaining a good retention rate is the next level, and then we have intrinsic helpers to the revenue growth that are listed here, like the growth of our clients, which is the contribution for pace of control our client funds. This assumes a regular non-changing interest-rate environment in the next few years. If rates were to increase, this contribution would be larger, and we still have an ability to moderately increase prices to our client base and capture price increases.

So, those are the basic fundamentals, with the key focus on the first two blocks for us as a management to execute.

In the future, this model bodes well, we hope. I mentioned in the beginning it should deliver us a top quartile S&P 500 performance. That's certainly what my bosses and the Board is looking for us as a management team to deliver, and my comment is I think the element of comfort is that is what we have been doing in the last few years and we're intending to continue to do it.

So that was a rush through our overall Company performance and I want to use the last few minutes I have to invite you to a few questions.



QUESTIONS AND ANSWERS

Unidentified Audience Member

(inaudible - microphone inaccessible)

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

I will repeat the -- yes?

Unidentified Audience Member

(inaudible). Can you explain it for a client going through the cloud solution, is that NPV accretive or positive for you? And then, does Cloud expand the addressable market? Is it easier to reach clients you couldn't reach before?

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes, so the Cloud transition has a few benefits for ADP. Number one, there's no change to our business model. So when we migrate a client to the Cloud, there will be -- in principle, we offer that migrational upgrade to the platform for no revenue increases. So the revenue would stay the same.

Effectively as they transition, they get a platform that is easier to buy more modules, and we do see revenue uptick as we migrate them and clients pursue us and buy more solutions from us. So, the revenue is either neutral because we had already a recurring revenue stream; we are just upgrading the technology below it. Or as they upgrade -- as they migrate to the better platform, they're buying more from us. So overall from a revenue perspective, the SaaS transition has been neutral to a slight positive for ADP.

The overall margin benefit is slight, but we do like SaaS platforms. They are a little bit more cost effective for us. So SaaS has been a good thing for us.

Accessing the broader market, I think, comes with our strategy of having a more comprehensive HR solution to it, not only payroll. So now you have a suite of bundles, and I think on the margin we are a bit more successful in playing when these larger HR decisions are being made and that offers us broader market access. So I would say also a slight positive overall.

Unidentified Audience Member

(inaudible - microphone inaccessible)

Jan Siegmund - *Automatic Data Processing, Inc. - CFO*

Yes, I'm glad you're asking because I don't want to avoid the question. Those of you who follow us, and you saw that in my last chart that we had a slight decrease in our quarterly retention that we reported. It was a little bit the only blemish in a very good quarter that we reported. And I think what we tried to illustrate in our call was that the reason we think we experienced this has a number of sources that are kind of at the heart due to our strategy that we are pursuing.

Number one, in the last quarter, the segment that was mostly affected by it experienced also twice the migration activity that it had in prior quarters, and I think as we talk to more clients and encourage them to upgrade, they may have used the opportunity to reach out and solicited also competitive bids into it.

I think a second reason that might come up is we had a lot of selling activity in the ACA space. And so when a client is now being asked to purchase an ACA or additional modules as part of an upgrade, I think it also offers them potential to consider this as an opportunity to evaluate the overall relationship.

Now this has happened on a relatively small basis, if you think, but it does happen and has, I think, caused our retention to dip in this quarter, unfortunately. We had a lot of activity in ADP. We had huge success in selling a lot of solutions. With that comes the opportunity to implement many clients that had put a lot of demands on our service organization.

So all these factors together, I think, have created an environment where we had higher losses than we really wanted.

As the only relief I can offer you, we had a very difficult grow over on retention. Not that I want to use that as an excuse, by no means, but our prior year first quarter had offered, I think, 70 basis points higher than historic high retention, so our grow over was particular difficult.

But nevertheless, it is a focus area for us as a management team. I believe we are already in process of mediating some of those others. Like the migration activities will not stop because we are fully committed to driving that strategic initiative of simplifying our operation and offering our clients the upgrade to these better solutions.

And so I think from that perspective, I think that cannot be totally avoided that we will have some future losses due to those migrations.

Unidentified Participant

Thank you. That's everything.

Jan Siegmund - Automatic Data Processing, Inc. - CFO

Thank you. Oh, that was very quick then. Thank you very much.

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