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ADP - Q2 2016 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

ADP reported 2Q16 diluted EPS of \$0.72. Expects FY16 revenue growth of 7% and adjusted diluted EPS growth to be 11-13%.



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PRESENTATION

Operator

Good morning, my name is Karen, and I will be your conference operator. At this time, I would like to welcome everyone to ADP's second-quarter FY16 earnings call. 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 second quarter FY16 earnings call and webcast. Carlos will begin today's call with some opening remarks, and then Jan will take you through the quarter's results, and provide an update on what to expect for FY16.

During our call today, we will reference certain non-GAAP financial measures, which we believe to be useful to investors. A reconciliation of these non-GAAP financial measures to their comparable GAAP measures is included in our earnings release, and in the supplemental slides on our Investor Relations website. I'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 results for our second quarter of FY16 which included revenue growth of 6% or 8% on a constant dollar basis. This solid revenue growth was impacted by about 1 percentage point from the sale of our AdvancedMD business at the end of the first fiscal quarter.

In the second quarter, we continued to see very strong demand for our solutions, which is evidenced by our new business bookings growth of 15%. Sales of additional human capital management modules that assist with the Affordable Care Act or ACA compliance continue to contribute meaningfully to this performance, which has exceeded our expectations on a year-to-date basis. As a result, we are now forecasting new business bookings growth of at least 12% for FY16.

In addition to delivering this solid performance, we've returned to shareholders an additional \$780 million through share repurchases in the first half of the fiscal year. And in November of 2015, our Board approved an increase of our cash dividend of 8%, marking our 41st consecutive year of dividend increases. These actions demonstrate our commitment to shareholder-friendly actions, and are intended to contribute to ADP's goal of achieving top quartile total shareholder return.

It has been an exciting and challenging quarter for ADP and our associates, as we help our clients prepare to comply with the ACA. Our teams have worked very hard to implement human capital management modules that were sold during calendar 2015, and I am pleased with the number of units started on our ACA platforms during the quarter. This is performance that we should be proud of, and I want to thank our associates for all of their hard work and dedication to our clients. We now have more than 14,000 US clients, with over 50 full-time employees live on our ACA solutions.

Let me put that achievement into perspective. By the end of March, employers with 50-plus employees will be required to send Form 1095-C to each of their employees describing the health insurance available to them. This is the most significant employee tax filing form that the US government has introduced since the W-2, and ADP is on track to deliver about 10 million of them in the first year. Success of our ACA solutions is just one example of ADP's proficiency in dealing with complex compliance issues, from helping clients determine eligibility for Work Opportunity Tax Credits signed into law just weeks ago, to preparing for anticipated changes in overtime rules, ADP's expertise is unique in the dynamic world of HR compliance.

And as this complexity grows, many clients choosing to outsource HR entirely to ADP. Our PEO business, ADP TotalSource experienced another strong quarter, growing revenue 18% and average worksite employees by 14% in the second quarter. With this growth, we eclipsed an exciting milestone. ADP TotalSource, already the largest PEO in the US, now supports more than 400,000 client employees. In fact, if ADP TotalSource were an independent employer, it would rank among the top five private employers in the US.

On the new product front, while in its early days, we're excited about the progress we're making with our analytics platform called ADP DataCloud. During the quarter, we fully released the benchmarking capability with more than a 1,000 job titles, which allows our clients to generate actionable insights from workforce data embedded in their ADP HCM solutions. The benchmarking platform available for US companies draws aggregated and anonymized information from ADP's large US client base. And, of course, ADP's data advantage is a global one.

During the quarter, we introduced the ADP France National Employment report as part of our commitment to adding deeper insights into the labor markets globally, and providing businesses, governments and others with a source of credible and valuable information. Similar to the US report, each month ADP will publish aggregated employment statistics from an anonymized sample, drawing from 1.3 million workers included among ADP's client base in France. These are just a few examples of ADP's leadership in the HCM category which continues to receive positive external recognition.

Most recently, Ventana Research recognized our ADP Vantage platform with its technology award in the business innovation category. In bestowing this honor, Ventana that recognized us for our ability to and I quote, help employees not just be efficient through modern user experience, but actually enjoy working with the application. It's always gratifying to see the HCM community recognize the progress we've made with our platforms.

And now, I'd like to give you an update on client retention. In the second quarter, ADP experienced a decline in retention of 120 basis points, which marks a sequential improvement over the first quarter. While we are disappointed to see this metric slip from its recent historical high, we are pleased that retention on our strategic platforms remains high.

Consistent with the first quarter, the majority of the retention decline stems from clients on mature technology, and we still believe that market activity from employers choosing their ACA providers has introduced a change event for our clients. Although disappointing, our management team remains focused on this metric, and we have taken actions to address opportunities we have for improvement.

Our progress on client migrations remains a key area of focus for us. And based on the success we've seen in our small business services unit with all clients now on ADP RUN, we believe these migrations are the right thing for our clients, and for the long-term success of our business. As evidence of this, in December, we reached a milestone as we were able to sunset the PCPW platform in the mid market, a legacy payroll product.

Many clients have chosen ADP for our strength and expertise in compliance. We are in a time, when the level of uncertainty in the regulatory environment is higher than it's been in decades. And as a result, our clients are even more reliant on our service teams. As a management team, we remain focused on the client experience, which includes staffing our service teams to the levels appropriate for assisting our clients with these HCM needs. Since last quarter, we have hired over a 1,000 associates to assist our clients, and expect to receive the benefit of adding these talented people in the coming months. Once again, I want to thank and congratulate these new, as well as our tenured associates, for their continued contributions to our success.

I'll wrap with just one reflection from our ReThink Global HCM conference, which I attended last week in Rome. There we had executive HR, finance, IT, and security leaders together to explore global perspectives around managing and cultivating the foundation of organizational success. It's clear that winning the war for talent, as well as handling compliance on a global scale are critical issues facing businesses around the world. What's even clearer to me, is that no organization is better positioned to help these clients than we are. With that, I'll now turn the call over to Jan for a further review of our second-quarter results, and an update on our FY16 outlook.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you very much, Carlos, and good morning, everyone. During the quarter, we realized a gain of \$14 million from the sale of a building. My comments on the quarter refer to adjusted results, which exclude the impact of this gain. ADP revenues grew 6% or 8% on a constant dollar basis. This growth includes approximately 1 percentage point of pressure due to the divestiture of the AdvancedMD business, which occurred at the end of the first quarter.

As Carlos mentioned, our new business bookings remained strong, posting 15% growth for the second quarter. Adjusted earnings before the interest and taxes were, adjusted EBIT grew 2%, or 4% on a constant dollar basis. Adjusted EBIT margin decreased about 70 basis points, compared to 18.7% in the last year's second quarter. Adjusted diluted earnings per share grew 4% to \$0.72 or 6% on a constant dollar basis, and benefited from a lower effective tax rate, and fewer shares outstanding compared with a year ago.

The slower earnings growth we realized in the second quarter, as well as the decline in margins were anticipated, as we made planned investments to increase operational resources in support of our service teams, and new product implementations. In addition, increased selling expenses resulting from higher than anticipated new business bookings, also contributed to the slower growth.

In our employer services segments, revenues grew 3% for the quarter or 6% on a constant dollar basis. This growth was primarily driven by net new business additions in the quarter. As a reminder, the new recurring revenue from ACA-related modules is not expected to impact revenue growth until the third fiscal quarter.

As Carlos discussed, client revenue retention decreased 120 basis points for the quarter, as we continue to experience elevated losses from clients on legacy platforms. Our same-store pace per control metric in the US grew 2.5% in the second quarter. Average client fund balances grew 4% compared to a year ago, or 6% on a constant-dollar basis. This growth was driven by additions from new business, as well as increased pace per control.

Outside the US, growth in our multi-national solutions remains strong. Employer services margin declined about 30 basis points in the quarter, due to planned investments that we have made in operational resources to install new business sold and provide services to our clients, as well as higher selling expenses from continued strong new business bookings.

ADP's PEO continues to perform very well, with revenue growth of 18% in the second quarter. As Carlos mentioned, the PEO reached a milestone in the quarter, surpassing 400,000 average client employees to reach 403,000, which represents growth of 14%. We continue to see an increase in benefit plan participation rates from our worksite employees, a trend we expect to continue for the remainder of the fiscal year. The PEO also continues to drive margin expansion through operating efficiencies, expanding margins by approximately 20 basis points in the quarter.

We are pleased with the progress we have made through fiscal year, for the first half of FY16, particularly with the success we have seen in new business bookings. As Carlos mentioned, we are now forecasting new business bookings growth of at least 12%, compared to our prior forecast of at least 10%. As a result of this change to our expectations, and the strengthening of the US dollar which occurred towards the end of calendar year 2015, we have updated certain elements of our FY16 forecast. ADP now expects FY16 revenue growth of about 7%, compared with our prior forecast of 7% to 8%.

This change is due to higher than anticipated pressure from unfavorable foreign currency translation, which is now expected to impact our revenue growth by about 2 percentage points for the fiscal year. On a constant dollar basis, ADP now expects revenue growth of 9%, which is the higher end of our previously forecasted range of 8% to 9%. This updated forecast reflects our increased expectations for new business bookings growth, as well as our confidence in the recurring revenue, which will start from new solutions sold over the past three quarters. And as a reminder, this forecast also includes almost 1 percentage points of expected pressure from the sale of the AdvancedMD business, which occurred towards the end of the first quarter.

For the employer services segment, revenue growth is anticipated to be 4% to 5%, compared with our prior forecast of 5% to 6% due to higher than anticipated pressure from unfavorable foreign currency translation. On the constant dollar basis, revenue growth is now expected to be about 7%, compared with our prior forecast of 6% to 7%. Due to the strong half performance -- first half performance of the PEO, ADP is now anticipating 16% to 18% growth for this segment, compared to our prior forecast of 15% to 17%.

Our forecast for adjusted EBIT margin, expansion of 50 basis points is unchanged. On the segment level, we are now expecting margin expansion of about 75 basis points in employer services, compared with our prior forecast of about 100 basis points. Margin expansion expectations for the PEO remain unchanged.

ADP has made some minor changes to our forecast for the client funds extended investment strategy to adjust for the December 2015 increase in the fed funds rate, as well as additional pressure anticipated from foreign currency translation that is expected to reduce our balance growth. These changes are not material to our overall forecast, and the details can be found in the supplemental slides on our Investor Relations website.

Adjusted diluted earnings per share is now expected to grow 11% to 13% from the \$2.89 in FY15, compared with our prior forecast growth of 12% to 14%. This forecast reflects additional selling expenses anticipated from increased new business bookings, higher than anticipated pressure from unfavorable foreign currency translation, which is assumed to have a negative impact of 1 to 2 percentage points on earnings per share growth.

On a constant dollar basis, adjusted diluted earnings per share growth is expected to be 12% to 14%, compared with our prior forecast of 13% to 15% growth. These changes to our full-year outlook reflect the results of our first half, and our expectations for the balance of the FY16. However, we continue to acknowledge that changing factors in the marketplace, due to uncertainty around ACA compliance could put a short-term strain on our earnings growth. We remain committed to our strategy and to our clients, which we believe will yield the best results for ADP over the long run.

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



QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Our first question comes from the line of David Grossman from Stifel Financial.

David Grossman - Stifel Nicolaus - Analyst

Thank you. I'm Given that a lot of the churn has happened in the legacy platform, should that favorably impact retention, just arithmetically as we go into the back half of the year?

Jan Siegmund - Automatic Data Processing Inc - CFO

So we have been keeping track of retention by platform, which is obviously what we have the information about, our legacy platforms versus our strategic platforms. And it's -- there's no question that the PCPW platform as it got into its final stages of migrations had a very low retention rate. But over the last 12 months, that was relative to the total size of ADP, and even to the size of our mid market business, I would say that it would not be a material change.

So we have other legacy products that are --they are larger and still have more clients on them that are also underperforming from a retention standpoint, that are a greater focus for us, than just the mathematical improvement from PCPW retirement. Because it's just not mathematically, I think significant because it's been waning over the last 12 months, even as we got close to the final retirement of the final clients.

David Grossman - Stifel Nicolaus - Analyst

I see. So I mean, if you just step back, and you just look at some of the changes, Carlos, in the enterprise IP stack, and the impact it's having on customer buying patterns, with that as a backdrop, are you seeing any change in the way the market is segmenting, between those that choose a platform like ADP with services wrapped around it, and the software-only platform? And if you are, what are the key differentiators that are changing between the different buyers?

Carlos Rodriguez - Automatic Data Processing Inc - President and CEO

I think if you take our new business bookings as an indication, it would seem that there's still quite a lot of strength and interest in buying a solution that has services wrapped around it. And I think, the fact that we've had these robust sales around ACA compliance which does include a service component to it, in terms of assistance with compliance --not just providing the software -- it reinforces our belief that we think our technology and services-enabled model is the right model. Doesn't mean that other models are not good, and that other people won't choose other models, but we like our approach. And it seems to be, frankly, right now gaining traction in the marketplace.

David Grossman - Stifel Nicolaus - Analyst

Very good. Thank you.



Operator

Thank you. And our next question comes from the line of Gary Bisbee from RBC Capital Markets.

Jay Hanna - RBC Capital Markets - Analyst

Hi, this is Jay Hanna, covering for Gary today. Just had a question regarding the buyback, are you anticipating using any additional operating cash flow, in addition to the \$2 billion you already plan on the buyback? Or are you happy with the offering covering this -- the buyback, the remainder of the next two years? Thanks.

Jan Siegmund - Automatic Data Processing Inc - CFO

Yes, you will see our cash balances of slightly below \$3 billion at the end of the quarter. And we stopped really thinking in ADP, about separating our initial debt offering from the cash at hand that is generated out of the operating cash flow. So we continue on a steady path of returning our -- the cash to shareholders. We are an ongoing share buyback program, and we'll proceed to work those cash balances down over time.

Jay Hanna - RBC Capital Markets - Analyst

Okay. Thank you.

Operator

Thank you. And our next question comes from the line of Sara Gubins from Bank of America Merrill Lynch.

Sara Gubins - BofA Merrill Lynch - Analyst

Thank you good morning. Could you remind us of where you are in the migration of mid market clients to Workforce Now, so what percent are still on legacy platforms? And are the retention issues largely concentrated with those mid market customers?

Jan Siegmund - Automatic Data Processing Inc - CFO

Yes, Sara. On -- we have a -- I give very rough numbers here, to give you more of an idea directionally -- around 75,000 clients in the mid market, and we have about 45,000 clients. So or around 60% or so on the latest version of Workforce Now. So this gives -- answers of a little bit of David's first question around the impact that the settlement of PCPW had, was a small client base.

And we still have a large number of clients to be migrated in -- in the remainder of this fiscal year and the next fiscal year. That's kind of -- those are big milestones, and we had [committed] prior that we are anticipating to make significant progress towards the end of FY17. That's still our plan.

Sara Gubins - BofA Merrill Lynch - Analyst

Great. And just from a retention perspective, is that really where the primary issue is?

Carlos Rodriguez - Automatic Data Processing Inc - President and CEO

I think that's -- that's fair. I think that's what we said in the first quarter, there really has been no material change. And again, I think that consistent with what we said in the first quarter, I think the pace of migrations was quite accelerated in the first quarter, versus the prior year first quarter.

And in the second quarter, it was the same, in part because we had a lot of migrations already in the pipeline, and we had momentum. And so, I think it's safe to say we're on -- kind of in the same place if you will, in terms of the pressure that migrations -- which with the benefit of hindsight -- and I take some accountability, or I take all the accountability as the boss for this, that migrations is a very big priority for us, but not at any cost.

And organizational, we have put a lot of focus and a lot of pressure, and the organization as usual responded to the boss. And I think we may have overdone it, and created an inordinate amount of pressure on the organization, as a result of the pace of migrations. I think we also have mentioned that, I think the ACA decisions that some of our mid market clients were making -- because in the up market, these are not decisions that you can make over the course of two or three months. And in the low end of the market, it doesn't apply because companies under 50 employees don't have to comply. So really is a mid market issue, and we think it had an impact. We just don't know really how to measure that.

And then lastly, I also acknowledge that, I think we exited the last fiscal year with not enough resources to handle everything I just mentioned, the extra activity around migrations, and all the activity and noise around ACA. So as we've mentioned in our comments, we've added resources, and we've taken actions. This is not the first time -- ACA is definitely a new factor, and the pace of migrations is something that -- with the benefit of hindsight, we probably stepped on the accelerator a little too fast. But we've been through this type of event before.

It seems similar to prior times, where there's really no concentration of any one particular competitor or any pattern that we can see, other than self-inflicted wounds that are repairable. And we're in the process of repairing them, and we see some signs of improvement. So despite the fact that we still have 40% of the clients in the mid market, doesn't necessarily mean that we'll have to continue to see -- and we don't plan on continuing -- we obviously have no -- we don't provide a forecast, and we don't provide guidance around retention, but I can assure you that we don't believe that we have to accept the retention levels that we have on our legacy platforms today. So we're not just standing idly by, and continuing on the same pace of migrations, and with the same actions, and don't expect the same results going forward.

Sara Gubins - BofA Merrill Lynch - Analyst

Great. Thank you.

Operator

Thank you. And our next question comes from the line of Lisa Ellis from Bernstein.

Lisa Ellis - Bernstein - Analyst

Hi, good morning, guys. Do you have any qualitative feedback that you get back from the sales teams out there, around how clients are thinking about the ACA implementation, and whether this is sort of it, as we go through this season? Or whether you expect, or they're anticipating making some additional changes over the next year?

Jan Siegmund - Automatic Data Processing Inc - CFO

Maybe two comments. Number one, the number of clients that we now have and are eligible, and for which the product is eligible, represents approximately -- sold about half of our client base. So we still have, I think another half of the client base that we expect will offer some future opportunities, although probably at a slower rate than we expect in the first year to sell the product.

And then secondly, the product is for use on an ongoing basis. So it's not really just the implementation and the printing of tax form. It is an advisory tool that helps clients to manage actually their liabilities, and the compliance on an ongoing basis. So it's really just a component of the HCM model that the clients use. And we expect the clients to benefit from it throughout the year, as they keep their employees in compliance, and like an ongoing tax filing offer.



Lisa Ellis - Bernstein - Analyst

Terrific. Thanks.

Operator

Thank you, and our next question comes from the line of Rick Eskelsen from Wells Fargo.

Rick Eskelsen - Wells Fargo Securities - Analyst

Hi, good morning. Thank you for taking my question. I guess, I was wondering if you could touch more on the new business bookings, and talk about the trends that you're seeing in terms of winning new clients, versus expanding and upselling with the existing clients? So what's been the biggest driver of the bookings beyond the ACA stuff that you're seeing? Thanks.

Carlos Rodriguez - Automatic Data Processing Inc - President and CEO

Again, given that we historically don't get into a lot of detail, for obviously competitive reasons on our new business bookings, in terms of breaking by segment or by product. But I think it's important for you to understand directionally. And so, I think what the wording we've used -- and I think it may have been in my comments or in Jan's opening comments is that clearly, ACA added to our new business bookings growth, and exceeded our -- or allowed us to exceed our expectations in terms of bookings.

So I guess, an indirect way of answering your question is that the long-term 8% to 10% new bookings growth that we strive for, absent change events like ACA, it would be safe to say that this year, we're on track to achieve that. And that performance above and beyond that would be attributable to ACA, and of course, that's only with six months done. That could change in the third quarter and the fourth quarter. But I think right now, based on the information we have, and what we see in terms of market activity, I think that's a fair way to fair way to look at it.

And it's important for all of you to understand that, because as Jan said, even though we still have an opportunity in front of us, the opportunity is obviously smaller now than it was in the prior year. And so, we don't expect to get as much lift. We hope we do, but we wouldn't expect to get as much lift from ACA in FY17, in terms of our new bookings growth. Having said all that, the most exciting thing for me around ACA and this event in general is that it should, and we hope will drive companies to look at the full HCM bundle.

So ACA compliance really requires that you have information, not just about how many employees you have, and what they're paid. But also about their time, how much -- how many hours they work per week, whether they have benefits or don't have benefits. So having, for example, a Workforce Now platform like we have in the mid market really helps a lot with ACA compliance. Not to mention that as we roll out analytics tools and other things to help manage people better, those are also attractive features. So I think the combination of the improvements in our user experience, the information that we provide through analytics, plus the advantages you get through compliance, we believe and this is our expectation and our hope -- is that that will continue to generate new business bookings growth, in terms of clients and also sales dollars into the future, even if the tailwind that we get from ACA diminishes a little bit in FY17.

Rick Eskelsen - Wells Fargo Securities - Analyst

Thank you. That's helpful. Just as a follow-up, I was wondering if you'd talk a little more on the mix shift you're seeing, in terms of strong new business bookings and still some challenges with the retention? Any margins implications we should be thinking about longer term here from that mix shift? Thank you.



Jan Siegmund - *Automatic Data Processing Inc - CFO*

So now, as you saw our adjustment for the forecast on margins is really primarily driven by only two factors. It's driven by higher selling expense, which is levels above our long-term expectation of new business bookings growth and FX. And so, you saw that in net, we upped our revenue guidance for the year on a constant dollar basis, on a slightly -- which kind of takes into account, the cost for a higher -- selling more clients. And of course, the slightly elevated or the elevated retention if you will. So it's all contemplated in this overall. So the recent adjustment to the margin has really mostly to do with FX and selling expense.

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

And I think the base, mathematically and with the information we have today, and baked into our forecast is an assumption that despite the pressure we're getting from retention, our revenue growth is accelerating as a result of our strong new business bookings growth. So I think net-net, Jan and I are happy. I think the organization is very happy, because obviously that growth rate -- our plan obviously is to get retention stabilized, and to make improvements in that area as you've heard because of our additional resources. Assuming that we do that, an acceleration in our long-term revenue growth rate is very, very positive for ADP, because of the recurring revenue nature, and the lifetime value of these clients that we're bringing in.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Thank you very much.

Operator

Thank you. And our next question comes from the line of David Togut from Evercore ISI.

David Togut - *Evercore ISI - Analyst*

Thank you. Appreciate the helpful detail you gave on the remaining conversion schedule, the Workforce Now. Just taking a step back, should we expect client retention to begin to improve again, once you complete the conversion to Workforce Now? Or are you just in general, seeing much greater competition in the mid market, and so retention should be something we should keep an eye on, even post the conversion to Workforce Now?

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

Again, consistent with what I mentioned in the first quarter, and I think I mentioned a few minutes ago, we have information around both our sales, successes against competitors, and we also have information around our losses against competitors. So unless all of a sudden, all of the competitors got together and did something different, there would be nothing in our information that shows that this is a competitive issue in terms of what's driving our retention. So I think that's one answer to the -- one part of the answer to the question.

So again, [note] we don't see any changes in the pricing environment or in the competitive environment. The -- in terms of the conversions and the migrations, it is -- it is clear as we're pointing out, that we're getting pressure on legacy platforms. But it doesn't mean that we can't have a better retention rate even on the legacy platforms. So take the example of our down market SBS business.

In that business we went through a migration similar to the one we're describing in majors over the course of multiple years. And as in this case, you have to balance speed with the desire to get done. And in that case, we felt some level of pressure around retention at various points. And when we were done with that migration, our retention rates have definitely improved. So they just didn't stabilize, but they improved.

But in the case of that client migration, we did not encounter some of these -- what we term as self-inflicted wounds that we're having here that we believe we can address, and we believe we can correct, as we're going through the migration. So, again, the problem is there's a lot of uncertainty, and it's very -- would be I think irresponsible for us to make definitive statements, because we just don't know for sure.

But I want to make sure that everyone is very, very clear that we believe that we can impact the retention rates in the mid market, even as we're doing these migrations. I also want everybody to understand that we're not going to stop doing the migrations, but we will moderate -- we still are on track to be finished by the end of FY17, which was our original plan. But the pace at which we do these, and the timing of when we do them, I think we will do on our terms, in order to maximize the balance between client retention, and also the long-term health of our business, and what's right for our clients.

David Togut - *Evercore ISI - Analyst*

Thank you. That's very helpful. Just a quick follow-up. Recognizing you don't give guidance beyond the current year, I'm just trying to understand -- clearly, the bookings growth has been terrific and well above expectations. Client retention possibly could be an issue going into 2017 as you continue to convert from legacy mid market on to Workforce Now. Should we think of the retention issue as being offset by the stronger bookings trajectory, or should we think that the retention issue potentially could be an issue for FY17 and beyond?

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

So I'm going to let Jan make a comment. But you -- again back to the discussion we had about PCPW, just if you think about this mathematically -- clearly, as we continue to migrate clients, the number of clients on legacy platforms becomes smaller and smaller, and mathematically, it has a smaller and mauler impact on our retention rate. So I would just caution a linear assumption around retention into 2017, even though that's clearly a possibility. But I would caution against making that assumption, because that base of clients is becoming smaller and smaller, and will have a smaller impact on our overall retention rate.

I also want to just reiterate and I'll let Jan weigh in, what we just said earlier, which is at this point our new business bookings is more than offsetting the pressure we're having from retention. And our revenue growth rate, we moved up in terms of our guidance for this year, and we're very, very happy with where we are versus our long-term range. We have said in the first quarter, and we will say again today, that in the second half of this fiscal year on a constant dollar basis, if you adjust for the AdvancedMD disposition which typically would have been included in discontinued ops but because of accounting changes is not in discontinued ops, so if you adjust for that we will be in the high end of our long-term revenue growth guidance.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

David, I think while we don't give guidance for FY17. Of course, we have to wait for two quarters for that, I have only maybe one more comment to emphasize. I think in the script Carlos, said, retention of our strategic platforms remains very good. So and I think out of that you can deduct, that as that base is growing, there should be a mathematical re-weighing of the retention rate that will help, and plus what we hope to achieve an improvement of retention in the legacy base. So those things together, plus our revenue update guidance, I think sends you the signal about how we think about the impact on retention really.

David Togut - *Evercore ISI - Analyst*

I just -- thank you very much.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you.

Operator

Thank you. And our next question comes from the line of S.K. Prasad Borra from Goldman Sachs.

S.K.Prasad Borra - Goldman Sachs - Analyst

Thanks for taking my questions. Carlos, just on the client migration levels, can you remind us what was the client migration level in mid market beginning of calendar 2015? And also a small clarification, is the FY17 objective for -- only for mid market, or does that apply to up market as well?

Jan Siegmund - Automatic Data Processing Inc - CFO

So I'll -- you addressed it to Carlos, but I'll give you some idea. We migrated almost 7,000 clients in the first quarter of FY16 in the mid market, and close to 4,000 clients in the second quarter. Year end, we slow migrations down a little bit, and for the reasons that Carlos described obviously, that tempered a little bit in the second half of the last quarter. So that migration pace compared to the prior year was accelerated, as we increased the resources available to them.

So you should expect basically, a continued focus on migrations, maybe at a similar level as last year, maybe slightly accelerated. We're going to go and determine that as operations allow, to maintain our goal of finishing migrations, the vast majority of migrations in the mid market by the end of FY17. So that's the goal. The up market migrations will be a multi-year effort, and we're going to proceed together in partnership with our clients. And I don't think we're going to give specific migration numbers for the up market, will be an ongoing effort to move those clients.

S.K.Prasad Borra - Goldman Sachs - Analyst

Jan, this question is definitely for you. Just on the margins, obviously, as your business is a mix of product services and various offerings from your end. To the point you can clarify, is the margin profile of the ACA business going to be -- post all this implementation costs and higher selling costs, is the margin profile going to be more closer to the products business, or is it going to be closer to the PEO business?

Jan Siegmund - Automatic Data Processing Inc - CFO

Well, that is a loaded question, because the PEO has pass-throughs in its P&L. And if you exclude the pass-throughs from the PEO margins, you'll see actually they're even slightly ahead of our ES margins. So the characteristic of ADP, in a very interesting way is that we have a margin profile that is actually very similar between our product sets. And even our HR BPO products excluding the pass-throughs have margin characteristics that are roughly in line for most of the cases, with our overall margin profile. So if you think about ADP as a kind of gross margin for an ongoing contribution of the recurring revenue model, the ACA product is expected to have exactly that margin profile. So it will not -- we don't think about it in any way different than the rest of our product set.

S.K.Prasad Borra - Goldman Sachs - Analyst

Okay. That's great. Thanks, Jan. Thanks, Carlos.

Carlos Rodriguez - Automatic Data Processing Inc - President and CEO

Thank you.

Operator

Thank you. And our next question comes from the line of Bryan Keane from Deutsche Bank.

Ashish Sabadra - *Deutsche Bank - Analyst*

Hello, this is Ashish Sabadra, calling on behalf of Bryan Keane. A quick question on the PEO, the gap between revenues and the worksite, that was 4% this quarter as well. On the last call, you had mentioned it may normalize to 2 to 3 points, and it looks like it's trending north of it. I was just wondering, do you continue to see some good traction there on the benefit option? What's driving it, and how do you think about that gap going forward for the rest of the year?

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

Yes, I think that -- you hit the nail on the head, which is the benefits -- the number of clients selecting, and the number of worksite employees selecting benefits, does have an impact on the growth of our top line revenue versus worksite employee growth, because of the pass-through nature of the benefits revenues. And so, we do have a chart that shows -- and I think we may have even mentioned it in our comments in the script, that the benefits participation rate is trending upwards.

So it had been trending downwards several years ago pre-ACA, and now it is trending upwards. It's not a dramatic increase, but it's enough to help drive additional difference between our worksite employee growth and our top line revenue growth. Which is why it's so important to look at the margin dynamics of that business excluding those pass-through revenues.

Ashish Sabadra - *Deutsche Bank - Analyst*

That's great color. And then, quickly on the pricing, during the key selling season, are you seeing any shift in the pricing environment?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

No, we observe pricing very closely, and two factors are important. One is our discounting levels as we distribute new business, in our new business bookings, and those discounting levels have been very consistent with prior quarters. So no change in the marketplace. And secondly, we indicated that our long-term goal is to have price increases to our client base closer to 50 basis points, than the historic 100 basis points. And we're trending right along that, right in between this year, a little bit less than 1% of price increases to our client base, unchanged and 100% in line with our expectations.

Ashish Sabadra - *Deutsche Bank - Analyst*

Okay. Thanks.

Operator

Thank you. And our next question comes from the line of Daniel Hussein from Morgan Stanley.

Daniel Hussein - *Morgan Stanley - Analyst*

Hi, Carlos and Jan. Thanks for taking the question. I want to ask a couple clarifying questions about new business bookings. So first, on your back half guidance, it seems to bake in 10% growth. Is that just conservatism, given you're really not sure what ACA demand will look like in the next couple quarters? Or are you actually already seeing some slow down there? And then secondly, I know new business bookings is -- it's a run rate

revenue number. So wouldn't there be FX impact in there as well, and therefore with newer bookings, a couple points higher? Or would it be very similar, given a lot of that came from the ACA product which is mostly US? Thanks.

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

I think both. At the risk of getting in trouble, I think the answer is yes to both questions. But it is what our forecast is, so we -- I think you're mathematically correct about the second half bookings growth. So I don't think we want to say much more other than, it's accurate that we have no real definite sense of what's going to happen in terms of this tailwind around ACA in the second half. And hence, it is what it is, in terms of our forecast.

And then, the second part of your question is accurate too. I would just remind you that our bookings outside of the US are not a large part of the overall sales results, but there would be some impact from FX in that. That would be a fair statement, but I would not -- I would not quantify it, in a couple of percentage points extra growth in new business bookings.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

I think that's fair. And maybe one pointer, that we finished our last FY15 in the fourth quarter with a very, very strong quarter. So there's a big [roll over] in the fourth quarter that you would also have to consider. So that probably factored also into our overall expectations.

Daniel Hussein - *Morgan Stanley - Analyst*

Got it. Thanks. And then maybe a high level question on PEO. So it's been growing at a healthy pace for the past, call it 15 years or so since you've been in the business. And I imagine a lot of your customer base has now been educated about it or has heard of it. But at the same time, the value prop seems to be increasing over time. So just in that context, is there a way that you can help us think about, maybe what inning we're in terms of double-digit growth? Or is it just really hard to tell, and it just depends too much on regulation and insurance and so forth?

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

Well, again, I'm not going to -- I'm not going to attempt to answer that question. Because if you had asked me is that question six or seven years ago, I would have probably said that it was going to get really, really hard because of how big the business has gotten. So we're selling now just each month, the number of worksite employees we have to sell in order to -- and start -- in order to maintain this growth rate is, close to what the size of the business was when I first entered that business. Because that's where I started my career, was in a PEO that then got acquired by ADP.

So I'm the wrong person to answer that question, in terms of -- because it is -- the law of large numbers -- is becoming as we've said, it's now one of the largest private employers in the US, but it's a very, very strong value proposition, with very strong momentum, a very talented management team. So we definitely don't have any plans to slow it down, and to see a slow down, because on a per client or per worksite employee basis, no matter how you look at it, that business is a winner for ADP. And we convert about -- half of the business that starts in the PEO comes from existing ADP clients that we upsell. And that's an incredibly powerful formula for us, because I think we're one of the few that have that advantage, of having the sales force and the installed client base that we have, that we have the ability to upgrade. So we're very, very happy with that business, and we hope that it continues to grow at these robust rates.

Daniel Hussein - *Morgan Stanley - Analyst*

Understood. Thank you very much.

Operator

Thank you. And our next question comes from the line of Tien-tsin Huang from JPMorgan.

Tien-tsin Huang - *JPMorgan - Analyst*

Hi, thanks. Just two questions. Just on the upper end of the market, the enterprise side of the market, what's going on there in terms of sales and retention? Any change in trend there, given the macro?

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

Again, we'll say that we try to avoid for a variety of reasons, getting into specifics by segment or by business unit.

Tien-tsin Huang - *JPMorgan - Analyst*

Okay.

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

But I think it's safe to say, that we don't see any -- in that business, you do have to look at, I think multiple quarters. I think one month or a couple of months doesn't -- does not make a trend, just because of the lumpiness of that business. But I think if you look at our up market business overall, I don't think we see any material change.

I think our Vantage platform is still selling well. Our multi-national international platform is selling well. I think on the retention front, there's really nothing to report either, in terms of any trends. So I think that we're, I guess, satisfied with that business in terms of -- obviously, we'd love to have more, but I don't think there's anything material to report in the up market.

Tien-tsin Huang - *JPMorgan - Analyst*

Thank you for that. And then just on the PEO. Just one question there. Just with, I guess, Paychex did introduce minimum premium plan. And I guess, [Trendit] is also looking to make some changes on how they handle the risk side of insurance. Given all these changes, does that create share opportunity for ADP, and are you considering making some changes as well? I'm assuming not, but I figured I'd ask, given some of the changes happening in the marketplace?

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

I think we're always looking at all of the -- all of our options, but there's no current plans to make any changes. And we have really no way of knowing what competitive impact it's going to have, in terms of what other people are doing.

Tien-tsin Huang - *JPMorgan - Analyst*

Okay. Thanks for taking my questions.

Operator

Thank you. And our next question comes from the line of Mark Marcon from Baird.

Mark Marcon - *Robert W. Baird & Company, Inc. - Analyst*

Good morning, and thanks for taking my questions as well. Just on PEO side, you mentioned that half of the clients are basically existing payroll clients. Can you describe a little bit, how much more profitable or what the revenue uptick is, when we typically go through a conversion from a payroll-centric to a more comprehensive PEO solution?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Excluding pass-throughs, it obviously depends on what the client had when they were a payroll client, and depends on what the pricing is when they become a PEO client, but you can think of the range being between 8 and 10 times multiple of revenue on a net basis, excluding pass-throughs.

Mark Marcon - *Robert W. Baird & Company, Inc. - Analyst*

That's great. And then, when we talk about the new bookings, how much of the new bookings is from upsells -- of either modules or versus brand new clients?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Well, Mark, historically our mix has been 50/50 -- about 50% of bookings roughly towards new client counts and new logos, and 50% of upsell. And but obviously, at the elevated levels of ACA selling, the mix has shifted a little bit because most of the ACA has been really selling to our existing client base. So in the current year, that mix is a little shifted. But as we indicated, without ACA we would have grown, with our long-term expectation of new business bookings growth of 8% to 10%. And for that component, it roughly holds in line.

Mark Marcon - *Robert W. Baird & Company, Inc. - Analyst*

Great. And then, you mentioned 14,000 clients using you for the ACA. Can you give us a percentage of the core target there, in terms of the companies above 50 employees, but not overly huge, that are using you for the ACA? Like how far penetrated are you? (multiple speakers)

Jan Siegmund - *Automatic Data Processing Inc - CFO*

In the first half, Mark, I think we have captured about half of the opportunity in total. At the large market, there is a smaller number. So at these ranges, it doesn't really make that big of a difference to include them or not include them. So I think if -- we have captured about half the opportunity.

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

Operator, we have time for one more question.

Operator

Thank you. Our final question for today comes from the line of Jim Macdonald from First Analysis.

Jim Macdonald - *First Analysis Securities - Analyst*

Yes, thanks for squeezing me in. With the fall selling season over, could you talk about if there are any qualitative differences in, like more active than normal, or are people frozen because of the ACA or?



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

I think based on our results, excitement would be the qualitative description, okay? (multiple speakers)

Jim Macdonald - *First Analysis Securities - Analyst*

[So you're at] --?

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

Yes.

Jim Macdonald - *First Analysis Securities - Analyst*

And then, you mentioned that the ACA revenue would be more felt in the third quarter, and that was maybe for the modules. I know you've been charging monthly to some people. Could you just talk about how the revenue from ACA will dovetail in?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, it is a -- it is a monthly per employee charge that the clients start to incur, with really January or February depending on when they launched with their products. So you will see the full swing of our implementations that we finished in December into January building up, and that's basically reflected in our revenue guidance. As Carlos indicated, we will reach -- by the end of the year, the double-digit revenue growth, the 10% revenue growth, if you adjust for FX and the impact of the AdvancedMD business. So you'll see it from our current organic growth rate accelerating to those levels, in order for us to make the full-year guidance.

Jim Macdonald - *First Analysis Securities - Analyst*

Okay. Thanks very much.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you.

Operator

Thank you. And this concludes our question-and-answer session for today. I am pleased to had the program over to Carlos Rodriguez for closing remarks.

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

So thank you all for joining the call today. We're obviously halfway through the fiscal year, and I think we've described some of the challenges we still have ahead of us, but it's obvious that we're very happy with the progress we've made. I don't usually use the word exciting, but I just used it in the last question to describe how we feel about our new business bookings growth. Clearly, getting some help from ACA compliance, but it's really an incredible achievement to have the kind of bookings growth we have this year, on top of what we had last year.



I want to also just remind the folks on the call, that we still remain committed to the shareholder-friendly actions that we've always been committed to around share repurchases, and increasing our dividend. And I want to end by, besides thanking all of you for joining us and thanking you for your interest in ADP, I just want to end by saying there's always been a strong work ethic here at ADP. But over the last 12 months, it has been a very challenging environment for our associates with the ACA rollout, and some of the challenges we've had around our resource constraints.

So I, once again, would like to thank all of our associates for their dedication to ADP, and more importantly to our clients. Thank you.

Operator

Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may now disconnect. Everyone, have a good day.

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