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ADP - Q3 2016 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 diluted EPS of \$1.17. Expects FY16 revenue to grow about 7% and adjusted diluted EPS to grow about 12%.



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PRESENTATION

Operator

Good morning. My name is Cat, and I will be your conference operator. At this time I would like to welcome everyone to ADP's third-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 Grilloit, Vice President, Investor Relations. Please go ahead.

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

Thank you. Good morning, everyone. This is Sara Grilloit, 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 third-quarter FY16 earnings call and webcast.

During our call today we will reference certain non-GAAP financial measures, which we believe to be useful to investors. A reconciliation of these non-GAAP financial measures to their comparable GAAP measures is included in our earnings release and in the supplemental slides on our Investor Relations website.

Before Carlos begins with a discussion of the quarter's results, 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.

So now let me turn the call over to Carlos.



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

Thank you Sarah, and good morning everyone. Thanks for joining our call and for your continued interest in ADP. This morning we reported results for our third quarter of FY16, which included revenue growth of 7%, or 9% excluding the impacts of foreign currency translation. In addition to the solid revenue growth, we continue to see strong demand for our solutions which is evidenced by our new business bookings growth of 13%.

While sales of additional Human Capital Management modules that assist with the Affordable Care Act, or ACA, compliance continue to boost our performance, we are especially pleased to see balanced growth contribution across our HCM portfolio. From further penetration of new applications into our base to growth in the number of clients choosing our higher touch HR outsourcing models, we are seeing continued traction for our technology solutions and our robust service offerings.

During the quarter ADP continued to focus on implementation of solutions that support ACA reporting requirements in the US. At the end of March employers with 50 or more employees were required to send form 1095C to each of their employees describing the health insurance available to them. This is the most significant employee tax filing form introduced by the US government since the W-2 more than 70 years ago and is significantly more complex for the employer to deliver. More than 25,000 clients ranging in size from 50 to 50,000 employees trusted ADP to assist them with ACA.

As of March 31, ADP delivered nearly 10 million form 1095Cs to these client employees. This endeavor was no small task. To put in it perspective, ADP processed nearly 60 million W-2 forms for the 2015 tax year, a form we have been producing for decades.

The W-2 requires one system of record, the payroll system, and is therefore significantly easier to produce than the 1095C which can require data from multiple sources. So as you may imagine, producing 10 million form 1095Cs in the first reporting year of these new regulations was demanding for us and required a strong partnership with our clients. This is another example of the breadth of our capabilities in the complex world of workforce compliance and I am very proud of the work our teams have done and will continue to do to help these clients navigate the uncharted waters of ACA reporting.

ADP's global capabilities also continue to be a differentiator for us. ADP first began offering global payroll services more than a decade ago and we have continuously expanded our offering across Europe, the Middle East, Africa, Asia Pacific, and the Americas. Last month we announced the expansion of our capabilities to seven additional locations including Angola, Tanzania and Zambia.

Now in 111 countries around the globe, ADP is bringing our global clients the benefits of integrated payroll solutions from a provider they trust. This ability to support the payroll compliance needs of global firms managing businesses in locales with constant changes in the legal and regulatory landscape is incredibly powerful and unrivaled in our industry.

Now I'd like to give you an update on client retention. In the third quarter ADP experienced a decline in retention of 30 basis points. We do believe the sequential improvement is a result of actions we've taken to strengthen our service capabilities. The talented professionals we've added to our service teams are now supporting our clients and although we have an easier year-over-year comparison, we expect the client experience to continue to improve as these associates gain more experience.

Aside from our clients' interactions with ADP through service and implementation, a key component of the client experience is our technology. We believe that our strategic platforms deliver best-in-class HCM capabilities in each of the markets they serve. And clients on these platforms generally have higher retention rates than those on our mature technology, so we are continuing to focus on upgrading clients to our modern cloud solutions.

As we've previously discussed, we intentionally slowed the pace of migrations in recent months so we could best assist our clients with ACA compliance. With additional talent in place and the effort of ACA reporting beginning to slow, we intend to return to a migration pace that will enable us to complete our mid-market upgrades to the latest version of Workforce Now by the end of FY17, which is in line with our previous expectations. Upgrading clients for mature technology is an important element of our strategy and the right thing for our clients.



Positive external recognition further bolsters our confidence in our product and service offering. Earlier this quarter we announced that Everest Group has once again named us as a leader and star performer in its annual Everest Group Peak Matrix for multiprocess HR outsourcing providers. The report cites the number of new deals, expanded global service delivery, success of our mobile solutions and the introduction of our analytics and big data solution called ADP Data Cloud as evidence of ADP's continued commitment to providing an enriched scope of solutions to our global clients.

It's flattering when influencers recognize our strategic progress, but it's even more rewarding when clients do. I recently had the opportunity to spend time with many clients at our annual ADP Meeting Of The Minds Conference which we just held in Washington, DC. Each year we use this opportunity to update our clients on our developments and share where we are headed while listening and learning more about their challenges.

What's clear is that these are challenging times for payroll and HCM professionals. ACA, globalization, regulatory complexity, the fight for top talent and changing workforce dynamics are all having a profound impact on how HR is practiced.

We've built our business to help clients through these challenges and many others. We are unique in our ability to deliver capabilities across the HCM spectrum from recruitment through retirement for businesses of all sizes around the entire globe. This was on display at Meeting Of The Minds, and the client response to our progress was gratifying.

So with that, I'll turn the call over to Jan for a further review of our third-quarter results.

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

Thank you Carlos, and good morning everyone. For the third quarter ADP revenues grew 7%, or 9% on a constant dollar basis. This solid revenue growth was driven by net new additions to our recurring revenue stream, including the impact of ACA-related revenue which began contributing to our growth in the third quarter.

Earnings before interest and taxes, or EBIT, grew 9%, or 10% on a constant dollar basis. This growth, while stronger than the first half of the fiscal year, continues to reflect additional costs related to selling expenses and incremental operational resources in support of new business sold. EBIT margin increased about 40 basis points compared to 24.4% in last year's third quarter.

Diluted earnings per share grew 14% to \$1.17 and reflected a lower effective tax rate and fewer shares outstanding compared with a year ago. In addition to delivering this solid operating performance, we have paid more than \$700 million in dividends and returned more than \$1 billion through share repurchases in the first three quarters of this fiscal year.

In our up Employer Services segment revenues grew 5% for the quarter, or 7% on a constant dollar basis. As Carlos discussed, client retention decreased 30 basis points in the third quarter and we remain focused on actions that will improve this metric. Our same-store pays per control in the US grew 2.5% and average client fund balances grew 2% compared to a year ago, or 3% on a constant dollar basis.

On a year-to-date basis we have seen a relative slowing in our pays per control metric compared with the 3% growth last year, which we believe is consistent with the US economy reaching high employment levels. As a result of improving employment, we continue to see declines in state unemployment insurance collections, which have had a drag on client fund balances but at a lesser rate than last year. This in combination with the weaker bonus season and the impact from client losses experienced in the first half has put added pressure on the growth of our client fund balances for the quarter.

Our business outside the US continues to perform well, driven by the strength of our multinational solutions which serve businesses of all size, from small to mid-market clients to very large global corporations. Employer Services segment margin declined about 40 basis points for the third quarter, this decline resulted from the impact of planned investments made in operational resources to implement the strong volume of new business sold over the last few quarters.



ADP's PEO posted another quarter of strong performance, with third-quarter revenue growth of 16% and growth in the average worksite up 14%. PEO also delivered solid margin expansion of approximately 50 basis points in the third quarter, driven primarily by operating and selling efficiencies as we continue to see good execution and increased productivity.

I'm pleased with the progress we have made, and will now give you an update on our expectations for FY16. For the fiscal year ADP still expects revenue growth of about 7%, or 9% on a constant dollar basis. As a reminder, this forecast includes almost 1 percentage point of expected pressure from the sale of the AdvancedMD business which occurred towards the end of the first fiscal quarter.

For the Employer Services segment, consistent with our prior forecast, revenue growth is anticipated to be 4% to 5%, or 7% on a constant dollar basis. For the PEO, ADP is now anticipating revenue growth of about 17% compared with our prior forecast range of 16% to 18%.

Our forecast for adjusted EBIT margin expansion of 50 basis points is unchanged. We are now expecting Employer Services margin expansion of about 50 basis points compared with our prior forecasted margin expansion of about 75 basis points. The margin in the PEO is now expected to expand up to 75 basis points compared with our prior forecast of about 50 basis points.

We have narrowed our forecast for average client fund balances and are now expecting 3% growth, or 4% on a constant dollar basis. We are also now are expecting growth in client funds interest revenue to be about flat to last year compared with our prior forecasted increase of up to \$5 million. This is a result of the lower interest rate environment from the softening of the global economy.

The total impact from the client funds extended investment strategy is still expected to be about flat compared to the \$419 million in FY15. The details of this forecast can be found in the supplemental slides on our Investor Relations website.

Adjusted diluted earnings per share are now expected to grow about 12% from the \$2.89 in FY15 compared with our prior forecasted growth range of 11% to 13%. On a constant dollar basis adjusted diluted earnings per share is expected to grow about 13% compared with our prior forecasted growth range of 12% to 14%.

And with that, I now 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 Jim Schneider with Goldman Sachs. Your line is open.

Jim Schneider - Goldman Sachs - Analyst

Good morning. Thanks for taking my question. I was wondering if you could give us an update on the improved client retention methods -- rates you saw in the quarter? Can you maybe talk about how much the rate of implementation slowed versus the prior quarter? You talked about the slowing there. And maybe give us an update on in the mid-market, I think you talked about 75,000 total clients and 45,000 on Workforce Now. Maybe an update on that 45,000 number, please?



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

I will let Jan maybe put in a couple of stats also, but the slowdown in implementation was really around migrations, just to be clear. And I think after the first quarter, I think we mentioned that we had begun already to slow down some of our migrations. Now, there continue to be some scheduled migrations that spilled over into the second quarter. So it is really towards the end of the second quarter, our fiscal second quarter, that we began to truly try to focus more on stabilizing our service organization and also our ACA implementations. And hence this third leg that was putting pressure on us, and the third leg of the stool which is an important part of our strategy but we felt we could, in the short term, slow down or take pressure off of ourselves, is what we did about the slowdown of the migrations. And that is exactly what happened.

To put it in perspective. In the first quarter of the year our migrations were more than double the same rate of the previous year's first quarter. We still did some migrations here in the third quarter, but I would say it was very, very low rates. And we got the desired impact, which has allowed us to focus on the other things that we had from of a volume standpoint on ACA and also trying to redirect some of those resources to stabilizing our service environment. I think we did exactly what we had planned to do and I think what we communicated. And I think we got desired result. As I mentioned in first and second quarter, there is no scientific way to know how much of each of those three things was putting pressure individually on our retention and our client service experience. But we basically had one that we had a lot of control over, which is migrations and we decided to slow it.

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

Maybe I will add on the migration pace, Jim, for you. I think we migrated -- in March we resumed the migrations. And I think it is in (inaudible). So the number of clients on the latest version for Workforce Now has not changed materially, really, compared to our last update. But we are still expecting to really complete the overall migrations in our mid-market onto Workforce Now to be completed by the end of FY17, as we had always planned for.

Jim Schneider - *Goldman Sachs - Analyst*

That's very helpful color, thanks. Maybe just as a quick follow-up. Could you give us an update on the migrations you are seeing in the up-market? Any rough metric in terms of percentage of clients completed on that side?

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

I think in the up-market it is probably more discussion around number of clients rather than percentages because I think it's just the nature of the business. I think there we are, I think, moving ahead with plans in terms of a similar strategy that we've had in the down-market and in the mid-market, which is to get our clients onto our strategic platforms over time. But I think as we've said over the last couple of quarters, I think it's probably not helpful, given that these are very identifiable clients, everybody knows who their names are, and most of our competitors know what platforms they are on. We don't believe that it is going to be fruitful and useful to us to get into a lot of detail around our schedules and which platforms and which clients we're migrating.

You should take from the messages that Jan and I just delivered on the previous question that you asked that we still believe this is the right thing to do. And the slowdown in the mid-market was really just related to all the other moving parts that we had, not because we believe it is the wrong thing to do. So we are still on the same strategy. Its, I think, consistent with prior quarters. We believe that the migrations and the upgrades in the up-market are going to take longer than they have taken in the down-market and in the mid-market, but we are comfortable with that because that's the different nature of the business in the up-market.

Jim Schneider - *Goldman Sachs - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from line of Sara Gubins with BofA Merrill Lynch.

Sara Gubins - BofA Merrill Lynch - Analyst

Thanks. Good morning. It's great to see the retention trend improving. Do you have any concern that it could get worse again as you ramp back up the migrations that have been slowed?

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

Obviously one of the, as you know, new business bookings and retention are the two numbers that are not, quote unquote, recurring revenues. Our business model is actually very stable, very predictable. Those two numbers are also relatively stable and relatively predictable. But they have more variability than the rest of our numbers. We have never try to forecast quarter to quarter or future quarters on either new business bookings or client retention for that reason. That's clearly a possibility, but it is not our plan.

You can tell by our desire, or actually our actions, to reignite our migrations that we don't believe that will be the case and we believe medium and longer term it is the right thing to do, which I think would lead you to the conclusion that the other factors like the high volumes of ACA and some of the service challenges we have around, which were related to ACA implementations and high volumes, the issues around inadequate service capabilities, I think were also factors that contributed to our retention issues. And we don't think it was only because of the client migrations. Otherwise we wouldn't be -- we would probably be following a different path.

I think we are confident it is still the right thing to do. As you know, we had e been doing migrations for several years and had not had the same kinds of issues that we experienced over the past couple of quarters with regards to retention. I think again, no scientific evidence, but I think we have a lot of ways of triangulating to the point where we think it is fundamentally the right thing to do. We ended up having more attach -- higher attach rates for our HCM modules. Our retention rates right now are higher on our strategic platforms than our legacy platforms. There is a lot of reasons that point to the need and I think the advantages of continuing with the migration strategy.

Sara Gubins - BofA Merrill Lynch - Analyst

Got it, thanks. Turning to margins. The ES guidance on margins suggests a pretty significant ramp year over year in the fourth quarter. Is that just the leverage on hires that you have already made? And are you now fully staffed up to higher migration and new sales or should we expect to see that come up more?

Jan Siegmund - Automatic Data Processing, Inc. - CFO

I think you are pointing out to one element, as now the revenue stream of the incremental revenues gets really a full quarter. So we see that, see that implicit revenue acceleration of fourth quarter when you dissect our full-year guidance that we confirmed. That will help. Secondly, the most important factor is in the fourth quarter we are anticipating -- we have a high investment of selling expense in the last year's fourth quarter and easier grow over. So with the confirmation of our new business bookings growth of 12% you can also see that we are not anticipating mathematically a [lower] fourth quarter because of that difficult grow over. And that will help on the margins.

Sara Gubins - BofA Merrill Lynch - Analyst

Great, thank you.

Operator

Thank you. Our next question comes from the line of David Grossman with Stifel. Your line is open.

David Grossman - Stifel Nicolaus - Analyst

Thank you. I'm wondering if we could talk just a little bit about the character of the business and how it is evolving? Given that the client base is mixing the bundled solutions, specifically ACA and PEO since they are presumably growing at faster rates, should we think any differently about how those clients feel differently than the traditional payroll business has over time?

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

Sorry, those clients scale in terms of -- can you be a little more -- is this (multiple speakers) margin question?

David Grossman - Stifel Nicolaus - Analyst

I was thinking that since the -- I'm sorry?

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

Is this directed towards margin?

David Grossman - Stifel Nicolaus - Analyst

Well, I was thinking more in terms of revenue growth, but you could include margin as well. I was thinking that because they are buying more that is, say for example, (inaudible) for a control increase, this business may scale a little bit differently than the traditional payroll business (inaudible).

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

I think we've been communicating for several quarters, and I think it is still true, that the products that we have that have the richest bundles, and it's not just PEO but it is our mid-market, what we call ASO and our BPO HR outsourcing solutions, they are all growing faster than our core business and they all have now, I think, very positive dynamics in terms of their margin, not that you asked specifically about margin. But they're also, I think, now at a size, all of them individually and collectively, where we are getting good contribution I think to our margin, certainly from a dollar standpoint and in many cases from a margin percent standpoint.

I think that is why we like our position in terms of where we are around starting with our richest bundles where there's really all-inclusive in terms of a full HCM bundle. The PEO's unique in the sense that it also has (inaudible) co-employment and provides healthcare and workers comp. Some of our other very rich bundles also are very, very comprehensive and growing very robustly and scaling very well. And we have been able to handle those volumes and have gotten good leverage on the margin side.

As you come down to more of our traditional products, as we've also communicated there, whether it is in Advantage or in Workforce Now, or even in the down-market, the attach rates continue to be better on new business than the penetration of our products in base. So I think that also bodes very well for us from a revenue growth standpoint and also from a margin leverage standpoint. I think we are happy directionally with where we are going. And where frankly the market is leading us, which is demand for these solutions is clearly high versus the traditional simple standalone payroll solution. We do sell simple standalone payroll solutions, but I think the market is leading us in the direction of more comprehensive solutions.



David Grossman - *Stifel Nicolaus - Analyst*

Okay, thank you for that. Just going back, I think there was a question earlier about the [up-market]. Recognizing sales cycles are long and is still early, could you talk a little bit more about your experience thus far and help us understand better what the competitive dynamic is there and where you are seeing success versus where there are some challenges as you approach that market?

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

I think the competitive dynamic in the up-market is not terribly different than the competitive dynamic in the mid-market and the down-market, which is that it's competitive and there is a lot of competition. But we are pretty happy with the progress of our Vantage platforms there in terms of new sales. And we mentioned that obviously we're going to be methodical and careful in terms of our upgrade cycle in the up-market, which I think fits naturally with the nature of that business anyway.

As you know, we have been investing heavily in all of our products including the up-market, but that also goes for Workforce Now in the mid-market. And we have made some significant investments over the years in RUN which is our down-market platform. I know it is hard to -- it's a very specific question about the up-market, but it's hard for me to really single it out as having a different approach or a different strategy from the rest of our Company because I don't think it is. I think we're on the same types of things.

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

Maybe if I add from a -- which will substantiate this with the colors on our new business bookings. We really tried to say we had balanced growth in the quarter and had experienced that actually for the last few quarter. And so the up-market is participating in the sales acceleration that we have seen for this year.

David Grossman - *Stifel Nicolaus - Analyst*

Okay, very good. Thank you.

Operator

Thank you. Our next question comes from line of Gary Bisbee with RBC Capital Markets. Please go ahead.

Jay Hanna - *RBC Capital Markets - Analyst*

Good morning. This is actually Jay Hanna on the line for Gary today. I was wondering if you could you shed any light on why we haven't seen more revenue acceleration, just given the strong booking growth over the previous several quarters, particularly this quarter as retention declined and we have started the new calendar year? Thank you.

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

I think as usual we have -- you can probably mathematically, as Jan probably has the math on the tip of his tongue, but I'll you from an overall big picture standpoint, mathematically you can tell that the fourth quarter we have a decent amount of visibility, given the nature of our business as to what is happening quarter to quarter. I think fourth quarter, I think, again when you exclude, which I think is the right way to do the comparison, you exclude the AdvancedMD comparable from the previous year. We don't have a lot of -- I think in fact our current forecast is to have much, if any, foreign currency effect in the fourth quarter.



I think you normalize for all those things and we are actually pretty happy with what our fourth-quarter revenue growth implies. And then the third quarter, I don't think we're -- it's not fair to say we're disappointed, because we're pretty happy. Whenever ADP's revenue growth incrementally moves up 0.5 to 1 percentage point, which again you normalize for AdvancedMD and you normalize for currency, that's what happened. That makes us very happy because in recurring revenue model in order to accomplish that, you have to, as you just pointed out, you have to have strong new business starts, not just bookings. And you have to have either stable or improving retention. And that is exactly what we got. There may have been a little bit of calendar noise and a couple of other things in the third quarter that we don't see in the fourth quarter happening. So we were actually pretty satisfied with kind of where we are, assuming that all of these things kind of hold that we've just communicated.

Jay Hanna - *RBC Capital Markets - Analyst*

Okay. And if I can get one more in. I'm just wondering, given the strong bookings growth related to the ACA offering, when that begins to slow, should we expect an overhang from that, as that service offering kind of begins to fall off and begins to drop?

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

I think that was something that I communicated in last quarter's call, which is again based on our kind of sense of the business and our experience and our knowledge, it is safe to assume that if we've sold, call it approximately half of the addressable market on ACA, we believe there is still a lot of opportunity in our client base. But obviously it is now half the opportunity that we had in the previous year. What we don't know yet is how people will react in terms of demand, because right now everybody is focused on getting the June deadline past them, in terms of the employer portion of the reporting, which is the 1094.

It is really a little early for us to know exactly how much ACA demand we will have or will not have. And we have been very, very transparent and very clear that it has provided a tailwind. However, we have also been very clear that we would be satisfied and happy to communicate our sales results both for the quarter and for the year to date excluding ACA. And that communication would lead you to believe that excluding ACA we'd be in the neighborhood of our long-term guidance around new business bookings. So we believe this has been incremental. We hope we will get more of it next year. But clearly the mathematics are such that it's going to create, I wouldn't call it a hangover or an overhang, but I would call it a very difficult compare that we, as we get further along in the next couple of quarters, will be able to hopefully communicate a little bit more clearly in terms of what that exactly means when we provide guidance for the next fiscal year.

Jay Hanna - *RBC Capital Markets - Analyst*

Okay. Thank you for the color.

Operator

Thank you. Our next question comes from the line of Rick Eskelsen with Wells Fargo. Your line is open. Please go ahead.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Good morning. Thank you for taking my question. Question, just going back to margins. I was wondering if you could talk a little bit more about the longer-term margin drivers. With you altering the outlook for the two segments here on the margin side, has anything changed longer term and more fundamentally that you fewer opportunities in the Employer Services and more on the PEO on the margin front specifically? Thank you.



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

No, we don't. I think that again when we have the kind of new business bookings growth that we have because of the way our P&L works around implementation expense and commissions and selling expense, it puts a lot of pressure. So honestly I would probably say that I'm incredibly proud of the organization's ability to, despite a very big ramp-up of expenses, some of which was related obviously to ACA, both around new business bookings cost as well as implementation expense, I'm actually quite proud of the organization's ability to deliver based on our forecast for the fourth quarter what will be some margin improvements that still kind of in the neighborhood of our long-term guidance. I think that leads me to believe that even though we still have a lot of investments we want to make in the business, I want to be very, very clear we are managing all of the variables in our business, including the need to continue to invest in our technology, in our associates, in a number of things.

But if in fact as Jan said, if the fourth quarter our new business bookings growth because, of growth over the previous year is smaller, that takes pressure off of us from a margin standpoint. The same would apply to next year. If we are not providing guidance in terms of our new business bookings growth for the next year, but mathematically if we get back into the long-term range of our new business bookings that will also provide tailwind and help take pressure off of our margin. Again, without getting -- I mean, I could go on for a long time in terms of how our business model works. But we feel pretty good, in fact, this year I think would give us a high degree of encouragement. It was hard. And people worked very, very hard on controlling all controllable expenses in order to still deliver the kind of margin improvement we are in face of the increased cost we had. But it just shows the power of the business model, and I think the ability of the Company to leverage its revenue growth.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Thank you. Just following up, just on the staffing up you did in this past quarter. Just curious if you are you fully staffed or completely right staffed for the migrations effort, or still more incremental hiring to do? Thank you.

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

I think one of the comments I made in my opening statement was around the -- what we are looking forward to is we added a lot of additional resources that are in the process of ramping up. In other words, of going through training. And frankly it's not just about training, because that's a relatively short process, but it's just the way it works probably in most companies that obviously as a person becomes more tenured, they become more effective and more productive. We do expect to have continued help from the resources that we've added. In terms of headcount, in terms of FD headcount, we believe we are fully staffed and that we are where we wanted to be at this point.

Rick Eskelsen - *Wells Fargo Securities - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from the line of Danyal Hussein with Morgan Stanley. Please go ahead.

Danyal Hussein - *Morgan Stanley - Analyst*

Hi, Carlos and Jan. Thanks for taking the question. Can you just talk about how the improvement in retention came in versus your expectations when you first set out and took actions to address it? And at this point, do you still have a backlog for ACA implementation, or are you fully caught up?



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

Yes. First, a disclaimer. Retention fluctuates over the quarter and has seasonality in it and changes. So we generally think about it as a longer-term type of trend. And I would say that the third quarter was right in line with our expected improvements for our full-year expectations. So we just make the progress we expected. And within the forecasting uncertainty that there is, we can kind of ride out in that range. So we are pretty happy about that.

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

You had a second part of your question?

Danyal Hussein - *Morgan Stanley - Analyst*

Just on the backlog that you had in the implementation.

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

We are still implementing ACA solutions. We have sold some ACA solutions for the next year. We are working on completing the delivery of product which centers around the employee -- employer part of the (inaudible) ACA. They are still in high gear. They're reaching out to clients. They are connecting and making sure everything is going well. So that activity has stabilized, obviously, and the bit push of the March deadline is behind us. But this is going to be now part of our regular business.

Danyal Hussein - *Morgan Stanley - Analyst*

Okay. A second question is on PEO. The spread between revenue growth and the average worksite employee growth had narrowed a bit in the quarter. Just wondering if there is deceleration of medical inflation or other pass-through taxes, or is it --

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

Mathematically, that is actually an astute observation. The answer is actually related to my comment that we had in the balance growth comments of my portion. Unemployment insurance rates have declined. So as a consequence of that, the pass-through (inaudible) rate has diminished the total revenue growth versus the processing revenue growth. That's the biggest factor. A number of ins and out. But nothing other structurally changing.

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

I think without getting into the weeds, the state employment that is Jan is referring to, it affects our balances and also affects the PEO, is a tax that gets capped fairly early depending on obviously on your wage. But it tends to be a first-quarter phenomenon. Again, we don't provide quarter-to-quarter guidance. But if you were to see that narrowing that you observed would be more pronounced in the first quarter and then --

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

In the first calendar quarter.



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

In the first calendar quarter, sorry, than it would be going forward. Just to help a little bit there.

Danyal Hussein - *Morgan Stanley - Analyst*

Understood, thank you.

Operator

Thank you. Our next question comes from the line of Jeff Silber with BMO Capital Markets. Your line is open.

Jeff Silber - *BMO Capital Markets - Analyst*

Thanks so much. I don't think anybody has asked about the pricing environment yet. So let me be the first to ask that question. How has it changed, if at all, over the past quarter or so?

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

Yes, we were expecting the question and we really have no news to report. It is really unchanged. We are continuing with price increases of less than 1% in our revenue growth. So we are executing against our long-term vision of price increases. Also discounting environment is similar. It varies by segment a little bit over quarters and how we manage our sales force. But no structural change in the pricing environment.

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

I think that's probably a good place to also mention, because it's a question we've gotten a couple of times in the last couple of quarters given the client retention questions. That again, Jan and I spend a lot of time, particularly when we have a full quarter look-out and then at the year-to-date numbers around wins and losses and competitors and so forth. I think I was very, very clear that we have a lot of competition in every segment of our market. But we really don't have anything to report in terms of any major changes around individual competitors, or as Jan alluded to, people changing their approach based on pricing or other factors. It's all kind of normal course and speed, if you will, but with a lot of competition, obviously, which we've had for number of years.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. Now onto a obscure question on taxes. We noticed that you've lowered your guidance for tax rates. I know it came in a little bit lower than expected for the quarter you just reported. Can you just give us a little color, what's going on there, and should that be the new tax rate we use longer term? Thanks so much.

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

No, you should not. These were one-time items that were actually in this case related to our prior bigger transactions on divestitures and the spin. So we just identified a little bit more opportunity that came in and then we hadn't forecasted.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, appreciate that. Thanks so much.



Operator

Our next question comes on the line of Jason Kupferberg with Jefferies. Your line is open.

Ramsey El-Assal - Jefferies & Co. - Analyst

Sure. This is Ramsey El-Assal standing in for Jason. When we look at the new business bookings, the healthy growth in new business bookings, how much of this is new business to payroll PEO versus competitor takeaways versus cross-sell?

Jan Siegmund - Automatic Data Processing, Inc. - CFO

The mix of our new business bookings is relatively stable. It for the total new business bookings picture is 50/50, approximately. 50% of our new business bookings is generated by capturing new clients and about 50% is generated by selling more product to our existing clients. Secondly, I think in detail, we don't disclose the sales volume on new business bookings volume to our PEO, but we have also prior -- in prior calls disclosed that about half of our business to the PEO is new clients and about half of the business comes from existing ADP clients that fuel the overall growth of the PEO. We have kind of this rule 50/50 and they apply consistently, and move actually very little quarter over quarter.

Ramsey El-Assal - Jefferies & Co. - Analyst

Okay, great. That's very helpful. In your Employer Services revenue, what percentage is now non-US? Has that split between Canada, Europe and other geographies changed? I'm just trying to get an idea sort of well in terms of whether there's been a shift in terms of the currencies you are exposed to? Granted, you're expanding pretty dramatically and across the globe.

Jan Siegmund - Automatic Data Processing, Inc. - CFO

Since Carlos (inaudible), let me answer that question. Carlos may have mentioned it, but we don't currently -- at current rates don't expect FX pressure for the fourth quarter. A little less than 20% of our revenues are international revenues that have been fairly stable over the last many years, actually. Our largest exposure is the euro and the Canadian dollar. Those are the majority that you would want to watch.

Ramsey El-Assal - Jefferies & Co. - Analyst

Great. Thank you very much.

Operator

(Operator Instructions)

Our next question comes from the line of Stephanie Davis with JPMorgan. Your line is open.

Stephanie Davis - JPMorgan - Analyst

Hey, guys. Thanks for taking my question. I know we've addressed this a bit for the mid-market. Can you talk to the mix of cloud versus legacy clients on a total Company basis?

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

I think on a client percentage basis, I think we have always been careful to make sure that we communicate very clearly on this because we've moved all of our down-market clients onto our cloud solution, and that is close to 450,000 clients. In terms of number of clients we have about 500,000 clients that are on our cloud products, which are strategic platforms. So percentage-wise, it's a very high percentage of our clients. But clearly from a revenue standpoint that would be different because our small clients' average revenue per client is much lower than our mid-market or our up-market. I think down-market, 100% of our clients, around 450,000 or on cloud.

In the mid-market we have probably over 60% or so of our clients on our strategic cloud solution. And in the up-market, I don't have that percentage off hand. Again, that is one where you really look at it on a client-by-client basis. But I think that gives you a little of a flavor of kind of where we are. Our plan obviously is to continue the upgrades in order to continue to drive those percentages higher. But that gives you maybe a little bit of color.

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

Yes, I think that's about it.

Stephanie Davis - *JPMorgan - Analyst*

All right. Thank you for the color. Just one follow-up on the retention side. With some macro employment improvements and the migration push, are you seeing any structural shift in voluntary versus involuntary attrition mix?

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

We do monitor the factors that are cause for our retention. If you take a multi-year look, which I think if you want to look at the economic factors that impact our retention, SPS is most affected by these economic factor, new business foundation and other business are impacting our ability to sell and impacting our retention rate in SPS. We had excellent retention rates in the down-market, partially aided by this improvement of the business environment overall.

That has been fairly stable for the last three quarters. So we have not seen a big change. Our comments regarding high employment and the economy were more geared as a general notion to the expectations that we had a very long positive economic cycle. And we see overall for the business potentially a slight slowing from a still growing trend, basically. So it is a very nuanced comment that we wanted to make, so ever so slightly we're coming close to what some people would probably describe as a full employment in the economy.

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

And the comment is really around pays per control growth rather than client retention, even though I think as Jan was alluding to obviously as the economic cycle matures, at some point there might be an impact on client retention. But for today I think our comments were really directed at our pays per control growth, because I think the math is very clear there. What we've seen in past economic cycles is you could possibly go for a few years with a kind of fullish employment type of situation which then impacts pays per control but doesn't necessarily impact client retention. But clearly if the economic cycle turns, we've been clear and very transparent around how our business model works. Particularly in a down market, a negative economic cycle has negative impact on our client retention.

Stephanie Davis - *JPMorgan - Analyst*

All right. Thank you, guys.

Operator

Thank you. That does conclude today's Q&A portion of the call. I'm pleased to hand the program back over to Carlos Rodriguez for any closing remarks.

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

I want to thank you for participating today. I just want to reiterate how proud I am of the organization's ability to get our solutions implemented on ACA compliance. Other than back to Y2K, during my tenure here at ADP this has been probably the most challenging time in terms of need to ramp-up resources in terms of implementations and service, and be able to absorb the new business bookings that we've had over the last several years. It was a lot of hard work and a lot of dedication on the part of a lot of associates. And I want to thank them specifically for everything they did for our clients.

I don't know if it was clear in the call today but when you look at our strong new business bookings, which now when you look at the compounded growth rate over the last 5 or 6 years in double digits, coupled with the improving trend on retention, what we have been able to do in terms of these ACA implementations, and despite all that deliver decent margin improvement, it's really a lot to be proud of. So I want to thank all the associates across all of ADP for their hard work and contribution to the success that we've had this quarter. And I want to thank all of you for joining us today. And I want to thank you for your interest in ADP.

Operator

Ladies and gentlemen, that does conclude today's conference. You may all disconnect. Everyone have a wonderful day.

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