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ADP - Q4 2016 Automatic Data Processing Inc Earnings Call

EVENT DATE/TIME: JULY 28, 2016 / 12:30PM GMT

OVERVIEW:

ADP reported FY16 revenues of $11.7b and reported diluted EPS of $3.25. Co. expects total revenue to grow 7-9% and reported diluted EPS to grow 6-8% in FY17.

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CORPORATE PARTICIPANTS

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

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

Jan Siegmund *Automatic Data Processing Inc - CFO*

CONFERENCE CALL PARTICIPANTS

James Schneider *Goldman Sachs - Analyst*

Christin Chen *Jefferies LLC - Analyst*

Sara Gubins *BofA Merrill Lynch - Analyst*

Ashish Sabadra *Deutsche Bank - Analyst*

David Grossman *Stifel Nicolaus - Analyst*

Rick Eccleston *Wells Fargo Securities - Analyst*

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

Gary Bisbee *RBC Capital Markets - Analyst*

PRESENTATION

Operator

Good morning. My name is Andrew and I will be your conference operator today. At this time I would like to welcome everyone to ADP's fourth quarter FY16 earnings call. I would like to inform you that this conference is being recorded and all lines have been placed on mute to prevent any background noise.

(Operator instructions)

I will now turn the conference over to Miss Sara Grilliot, Vice President of Investor or 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 fourth quarter FY16 earnings call and webcast. Before we begin, you may have noticed in the slide presentation posted on our website that we included the detail of our client funds available for sale portfolios as of June 30th, 2016 which shows the embedded book yields of the portfolio by year of maturity. This is chart is in the appendix of the presentation and is provided for your information.

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 sides on our Investor Relations website.

Before Carlos begins, 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 filing with the SEC for additional information on risk factors that could cause actual results to differ materially from our current expectations. Now let me turn the call over to Carlos.

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

Thank you, Sara, and good morning everyone. Thanks for joining our call and for your continued interest in ADP. This morning we reported solid results for the fourth quarter and full FY16, with revenue up 8% for the quarter and 7% for the year. Excluding the impacts of foreign currency translation, FY16 revenue grew 8%.

Please keep in mind that our 8% growth in FY16 was negatively impacted by about 1% from the sale of our AdvancedMD business, which occurred at the end of the first fiscal quarter. In addition to the solid FY16 revenue growth, I'm very pleased with the robust new business bookings results we experienced during FY16, posting 12% growth for the year. This represents $1.75 billion in new recurring revenue generated by our sales force during the fiscal year.

Strong sales of human capital management modules that assist clients in complying with the Affordable Care Act contributed meaningfully to the out performance we've seen in new business bookings for the past two fiscal years. This important regulatory change impacted the ATM industry in material ways. ADP responded well and sold our ACA compliance solutions to about half of our addressable base in a relatively short period of time.

Because of this very strong recent performance, and the resulting difficult compare, we expect FY17 new business bookings to grow 4% to 6% from the $1.75 billion sold in FY16. If achieved this will result in a three year compounded annual growth rate of 9%, which is within our long-term expected range of 8% to 10%.

FY16 was an exciting year that showcased ADP's agility as we continued to adapt to the dynamic needs of our clients. When we look back at our progress, it's clear that the long-term trends we see with respect to the changing nature of how work is done, the increasing complexity of regulatory compliance, the trend toward harnessing the power of big data and HR, and the need to work seamlessly across geographic boarders are all having positive impacts on our success.

We've responded to these trends in many ways during the year. For example, across the portfolio, we've dramatically improved the user experience of our clients' employees.

In doing so, we've made our products easier to use and more consistent with how employees engage with consumer technology and social media. If your company is an ADP client, I invite you to join the more than eight million users of ADP's mobile app to experience this for yourself.

We've leveraged our unique data set of 26 billion payroll records to introduce significant new data analytics capabilities. Since introducing ADP DataCloud just over one year ago, we now have more than 2,500 clients using this solution to generate actionable insights that help address work force productivity, contribute to talent development, and assist with employee retention.

We've expanded our capabilities geographically and can now meet the payroll processing and compliance needs of companies with operations in more than 110 countries and territories, which is a key differentiator in our industry. And we've met the challenges presented by the implementation of the Affordable Care Act in the US. With strong demand for our ACA solutions, we made investments in operational resources and successfully helped more than 25,000 clients process more than 10 million form 1095-Cs, the most significant new employee tax form introduced by the IRS since the W-2.

As we've discussed, we believe our investments to innovate and simplify our portfolio are essential for our long-term success. We believe our strategic platforms now deliver best-in-class HCM capabilities in each of the markets they serve, and we've seen solid retention rates from clients on our strategic platforms.

Therefore, continuing to upgrade clients to our modern cloud solutions remains a critical area of focus for us and is the right thing to do for our clients. Today, all of our small business clients are on the RUN platform, and during the fourth quarter we increased the pace of our client migrations in the mid-market and now have about 49,000 clients on the latest versions of Workforce Now.

With 2/3 of this base now upgraded, we expect the balance of our Workforce Now clients to be transitioned to the current platform by the end of FY17. As we continue to move clients onto our strategic platforms and have more clients engaging ADP for multiple services across the HCM spectrum, we're embarking on a path to simplify our service model for our associates and our clients.

Over the past several years, our technology platforms have evolved to meet the dynamic needs of our clients, who are choosing to engage in a more comprehensive way with their HCM providers. As a result of this shift, a new approach to service is essential to support the HCM Company that we've become, and extend our leadership in this growing market, and I'm therefore excited to tell you about a service initiative we're kicking off in FY17.

This new initiative is designed to better align our service organization to work across traditional lines, leverage best-in-class service tools and processes and establish teams with expertise across the HCM spectrum. We believe this will enhance the client experience and at the same time allow us to better transfer knowledge among these service teams and offer robust career opportunities within the service organization, all of which benefits our clients and our associates.

As we begin to build out this new service model, we believe there's a benefit to be gained by collocating certain US service capabilities at existing and new ADP locations in the US that have the scale to support the strategy. We have had positive experiences creating centers like these at sites such as El Paso, Texas; Augusta, Georgia; among other places.

We've recently selected Norfolk, Virginia and Maitland, Florida, near Orlando, as our next two locations and have started building cross-functional service teams at both sites. We will announce a third new site in the western part of the US later this year. As part of this initiative, we will focus on building service capabilities within these and our existing other locations while streamlining our geographic footprint.

In connection with these efforts, ADP will be making certain investments in FY17 which are expected to put some pressure on our margin expansion goals for the year. Jan will provide more detail when he reviews FY17 outlook. However, we do expect our margin expansion in FY17 to be lower than our long-term goal of 50 to 75 basis points as we make these important investments.

Now let's spend a few moments on retention. During the fourth quarter, we experienced a retention decline of 80 basis points, and for the full fiscal year, retention declined about 1 point to 90.5%. Similar to previous quarters, we continue to see a concentration of losses from clients who are still on legacy technology, and while we have seen some of the benefits from investments we've made in service during the early part of FY16, we continue to experience variability in our retention metric.

In closing, FY16 was an exciting and challenging year for ADP. We achieved strong revenue growth driven by sales of additional HCM modules to support clients with the new ACA requirements. We invested in implementation and operational resources to support this revenue growth while still delivering solid margin expansion, and we did this while remaining consistent with our commitment to shareholder-friendly actions.

During FY16, we returned about $2.1 billion in cash through dividends and share repurchases and increased our dividend for the 41st consecutive year. I am confident that as we successfully execute against our strategy, we will continue to drive results for our clients, our associates and our shareholders.

And with that, I'll turn the call over to Jan who will review our FY16 financials and share our FY17 outlook.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you very much, Carlos, and good morning everyone. During the fourth quarter, we took a severance charge of $48 million that was related to a broad-based workforce optimization effort.

Certain non-GAAP measures and my commentary to follow exclude the impact of this charge, as well as certain other one-time items recognized earlier in the fiscal year. A reconciliation of these non-GAAP measures can be found in this morning's press release and in the supplemental charts of our Investor Relations website.

As Carlos mentioned, FY16 was a successful year for ADP. New business bookings grew 12% to $1.75 billion sold. Revenues grew 7% to $11.7 billion. Excluding the impacts of foreign currency translation, revenues grew 8% for the year. On a reported basis, net earnings grew 8% and diluted earnings per share grew 12%.

Adjusted earnings before interest and taxes, or adjusted EBIT, grew 10%, or 11% on a constant dollar basis. For the year, adjusted EBIT margin expanded 60 basis points from the 18.8% in FY15. I'm pleased with this solid margin expansion, which includes the impact of investments and operational resources that were made during the fiscal year as we supported our clients through the first year of the ACA related reporting requirements.

Adjusted diluted earnings per share grew 13% to $3.26, reflecting 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 $900 million in dividends and returned about $1.2 billion through share repurchases for FY16.

During the fourth quarter, ADP returned $100 million to shareholders through share repurchases, which was at a reduced pace compared with prior quarters. Market conditions were not a factor and our longstanding commitment to return cash to our shareholders remains unchanged.

So now, for a discussion of our segment results. In our employee services segment, revenues grew 5% for the year, or 6% on a constant dollar basis. This growth was driven by additions to new recurring revenues during the fiscal year from strong new business bookings sold.

As Carlos discussed, client revenue retention decreased 80 basis points in the fourth quarter, and for the year revenue retention declined about 1 point to 90.5%. Our same-store pace for control in the US grew 2.5% for the fiscal year. Average client fund balances grew 3% for year, or 4% on a constant dollar basis. This growth was slower than in prior years, primarily related to the declines of state unemployment insurance collections as the result of an improving labor market in the US.

This, in combination with the impact from client losses experienced end of the year, has put added pressure on the client funds balance growth. Our business outside of North America continues to perform well despite an uncertain global environment. This performance is driven by continued strong demand for our multinational solutions, which serve businesses of all sizes and are now the largest contributor to our sales outside of North America.

Employee services segment margin increased about 60 basis points for the fiscal year. This increase was driven by reduced selling expenses in the fourth quarter compared to last year's fourth quarter, partially offset by the negative impact of planned investments made throughout the year to support our clients with the first year of ACA compliance.

The PEO had a successful year, posting revenue growth of 16% and average worksite employee growth of 13%. Let me make a few comments about fourth quarter revenue growth in the PEO, which trended lower at 13% growth compared with the previous three quarters in FY16.

This revenue growth deceleration was based on two factors. First, regarding our gross revenues, which include pass-throughs, our clients experienced a favorable impact from lower healthcare renewal premiums during our fourth quarter, which contributed to a lower relative gross in our pass-through revenues.

Second, in the fourth quarter we noticed some variability in the timing of payrolls run by our clients. This type of timing variability has occurred in the past and should not be viewed as an indicator of any underlining change in the fundamentals of the business.

We remain pleased with the performance of our PEO, which had strong worksite employee growth of 13%, and we're happy to see that the PEO also delivered strong margin expansion of approximately 70 basis points for FY16, which was primarily driven by operating and selling efficiencies from increased productivity.

This is solid overall performance for FY16, with strong new business bookings yielding healthy revenue growth and solid margin expansion despite the initial investments we made during the year. I'm pleased with our results and will now take you through our expectations for FY17.

As Carlos mentioned, for FY17, we are expecting new business bookings growth of 4% to 6%, from $1.75 billion sold in FY16. We anticipate total revenue growth of 7% to 9% for the year, which is not expected to be significantly impacted by foreign currency translation based on current rates.

This forecast assumes 4% to 5% revenue growth in the employer services segment and growth in pays-per-control of 2.5%. Revenue growth for the PEO is expected to be 14% to 16%. ADP's adjusted EBIT margin is expected to it expand 25 to 50 basis points from the 19.5% in FY16, which is below our goal of 50 to 75 basis points of margin expansion over the longer run.

We are still committed to this margin improvement goal over the longer term, but as Carlos mentioned, we're making investments in FY17 to align our service model in support of our technology strategy. We expect these operational investments will put about 20 basis points of pressure on our FY17 margins, and as a result of these build-out of the new facilities, total expenditures/capital expenditures for FY17, I expect it to be about $250 million.

In addition to these investments, we also anticipate certain one-time charges of $100 million to $125 million throughout FY18. Of this, $45 million is expected to be incurred during the first quarter of FY17 and $45 million in the latter part of the year, with the remainder expected in FY18.

These charges are excluded from our FY17 forecast for adjusted EBIT margin expansion and from our adjusted diluted earnings per share forecast. A reconciliation of these metrics can be found in this morning's press release and in the supplemental slides on our Investor Relations website.

On a segment level, we anticipate pretext margin expansion of about 50 basis points for employer services and 50 to 75 basis points of margin expansion in the PEO. On a reported basis, diluted earnings per share is expected to grow 6% to 8% compared with the $3.25 FY15.

Adjusted diluted earnings per share is expected to grow 10% to 12% from the adjusted $3.26 in FY16 and contemplates an adjusted effective tax rate of 33.3%, consistent with the 33.3% in FY16. In accordance to our continued shareholder-friendly actions and our intention to return excess cash to shareholders, our earnings per share forecast assumes that excess cash of $1 billion to $1.4 billion will be returned via share repurchases during FY17.

This forecasted range includes anticipated share repurchases required to offset employee benefit plan issuance, and the timing of these share repurchases is dependent upon market conditions. So with that, I will take you through our forecast for the client fund extended investment strategy.

First, a reminder that the objectives of our investment strategy remain the safety, liquidity and diversification of our assets. As of the end of the fiscal year, approximately 80% of our fixed income portfolio was invested in AAA and AA-rated securities.

In a typical year, our strategy results in about 15% to 20% of our fixed income investments maturing, and this year we expect the percentage of maturities will be closer to the lower end of this range. We continue to base the interest rate assumptions in our forecast on the Fed funds future contracts for the clients' short and corporate cash portfolios.

And the forward year curves of the three-and-a-half and five-year US government agency forward year curves for the client and corporate extended and the client long portfolios, respectively. And as we do not believe it is possible to accurately predict future interest rates, the shape of the year curve and the new bond issuance behavior are corporate and other issuers.

For FY17, we anticipate growth in the average client funds balances of 2% to 4% from the $22.4 billion in FY16. We anticipate that the yield of the client fund portfolio will remain about flat at 1.7%, compared with FY16. These factors are expected to result in an increase of up to $5 million to client fund interest revenue.

The total contribution from the client funds extended investment strategy is expected to be about flat to FY17. The detail of this forecast is available in the supplemental slides on our website.

And before we take your questions, I wanted to let you know that Sara will be taking a new role within ADP finance as a CFO of one of our business units. I want to thank Sara for her contributions leading our investor relations program and welcome our new Head of Investor Relations, Christian Greyenbuhl, who was recently -- who has recently led ADP's global accounting team.

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

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator instructions)

We will take our first question from the line of James Schneider from Goldman Sachs. Your line is open.

James Schneider - *Goldman Sachs - Analyst*

Good morning. Thank you for taking my question. I was wondering if you could maybe give us an update on the migrations in the mid-market segment. I think you said 45,000 had already migrated. It sounds like maybe that's under 40,000 clients to go.

Can you maybe talk about any changes you're seeing in terms of, as you make those migrations, whether you're seeing any kind of additional client losses, and maybe you can just talk about the pace of migrations over the course of FY17, whether that's going to be back or front-half loaded or just ratable over the course of the year?

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

Sure. I think that -- I think the number was really 49,000 that have been migrated, and I think we have about 25,000 to go.

In terms of the other questions, you know, we did have some time to kind of reset how we were doing migrations and the pace also based on, you know, I mentioned that there were three factors that I think impacted our retention back over the last three quarters, and we think one of them was the pace of migrations and also the execution around migrations. So a lot of work was done during what we call our year-end blackout.

Because we really prefer not to do migrations anyway in the call it November to January, February time frame, because there are so many things going on at the calendar year-end in a typical HCM payroll company. And so that gave us a little bit of time for those folks to focus on kind of stabilizing that organization and rethinking what the proper pace is, and to put it in perspective, we migrated approximately 4,000 clients during the quarter.

And when we experienced challenges with some of the migrations, we were up as high as 7,000 in a quarter. This is back in the beginning of this fiscal year. So hopefully that gives you a little bit of color, and I think the overall comment is clearly I think our competitors are fishing in those waters, because we see it in the numbers in terms of our losses being concentrated in our legacy platforms.

And we're trying to reduce the size of the fishing pond, so there's still some variability there in the retention. But I think we've gotten better at how we're doing the migrations, and I think our pace is more manageable and I think easier for us to control at this point.

Operator

Thank you. Our next question from the line of Jason Kupferberg from Jefferies.

Christin Chen - *Jefferies LLC - Analyst*

Hello there. This is Christin Chen for Jason. Thank you for taking my question. We were under the impression in FY16, your bookings growth in excess of the traditional 8% to 10% range was mostly due to ACA.

Just looking at the 4% to 6% for FY17, it would imply a slowdown of, you know, kind of more than just what the tough comps from ACA would imply. Can you just talk about the things you're seeing or the underlying drivers behind that deceleration for this metric? Thanks.

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

Sure, I will let maybe Jan talk a little about the math, but I think the math does kind of work in within maybe 0.5 point to 1 point, one way or the other depending on your perspective. Because we don't provide exact numbers. But we want to reiterate that we had strong growth in new business bookings this year excluding, ACA.

And then mathematically, what that creates is a grow-over for next year. I think I've previously said and we will say today that we don't expect the same level of new business bookings from ACA. Since we've already sold half of our addressable market, even if we assume that we sell half of the remaining half next year, that creates a mathematical grow-over issue for us. I'll let maybe Jan comment on the math.

But I think the message you should hear from us is that we believe over the course of three years, as you can imagine, we look very carefully about, is the sales strength coming from core operations, is it coming from additional business, is it coming from ACA, and we feel pretty good on a three-year compounded basis about where our new business bookings growth is right now.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, thank you Carlos. And their are two different methods you can look at this, you could exclude the ACA impact on all three years and look at the underlining growth of the rest of our new business bookings. We would be delivering exactly what we have said are in-line with our long-term goals expectations of 8% to 10% over those three years.

And you can also look at is the decline driven by a slowing of ACA sales in FY17, and that is yes, because we have at rest already half of our business opportunity in the first year, and we don't expect to close, cover 100% of the sales opportunity in FY17. So we had to make assumptions about that and so both are in line within a percentage point plus, minus. So this is for government work, an estimate that keeps it intact.

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

Yes, I think just -- more government work, again, these are not the right numbers, but mathematically if you take 4% out of the 12% it gives you 8%. And if you add 4% to the 4% to 6%, you get back to 8% to 9% and you're still within the 8% to 10% range. So I hate to be so simplistic, but I think that's really the way the math works.

Operator

Thank you. Our next question comes from the line of Sara Gubins from BoA Merrill Lynch. Your line is open.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Hello. Thank you, good morning. The EF guidance for 4% to 5% revenue growth just slower growth in constant currency than what we've been seeing recently, in spite of the ACA bookings that you got this past year. Is that because of retention, and could you give us any color on what kind of revenue you did get from ACA last year and what you're expecting for this coming year?

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

I think that the ES revenue growth has been accelerating for the last five years. And I think some of that obviously is driven by the economy, in terms of as the economy rebounded, I think we had some help in pace per control and a number of other factors, and just the strong new business bookings growth has created a bigger gap between our starts, what we call our starts and our losses. And I think that has contributed to this accelerating growth in employer services.

I think you're right that the losses that we experienced this year obviously have an effect this year and they have an effect on the following year as well. But again, back to kind of simplistic math for government work, I think we're probably plus or minus 0.5 point in terms of ES revenue growth. So maybe some of that is rounding, but we don't feel any weakness, I guess, to be clear. And the ACA revenues, Jan probably has the exact number, that clearly provided lift in our new business bookings and does provide lift to revenues that then also presents somewhat of a grow-over.

It's not as pronounced a grow-over, because it's a revenue number versus a new business bookings number, but it does have the same impact. But we feel where we are right now, employer services, feels like a pretty good place in terms of trend and, in terms of trajectory as well.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

And we don't provide, really, the precise revenue numbers, but it's kind of a little bit above, in the $100 million plus range of ACA impact to ADP.

Operator

Thank you. 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. Just a follow up question on retention. So last quarter, you had mentioned you had taken steps around improving the service capability which gave you some more confidence around retention, but we still saw the retention grow -- or decline.

Now my question was when you think about the mid-market customer base you still have 25,000 customers remaining, which are going to be migrated over the next four quarters, and normally you don't do the migration in November, December which should imply around north of 6,000 customers being migrated every quarter, versus 4,000 that you saw in the last quarter.

So with this elevated level of migration, how should we think about retention going forward? Could we see retention get worse before it starts to get better? Any clarity that you can provide on the retention front, that will be helpful. Thanks.

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

Sure, it's a good question, it's a fair question. I think your math is actually very close, the only thing I would add to that math is that, you know, you do have to apply a retention -- or a loss factor to that 25,000 itself over the course of 12 months. We naturally, even if we weren't migrating, would lose call it 10% of those clients. It might be a little bit higher than that, just because they're legacy type clients.

The absolute number you're starting with that you have to divide over four quarters is a little bit smaller. But you're in the right ballpark. It's probably around 5,000 or so clients that need to be migrated per quarter.

We feel pretty comfortable with that pace, given the infrastructure that we've created and the new process we have for migrations. In terms of additional color, as you're pointing out, the results didn't cooperate with our desires and with our intentions and in part, that's because our retention is a reflection of the overall Company's results and there's variability across a lot of other businesses.

I wouldn't read in to it, even though we still have a concentration of our retentions issues in the mid-market, and they have been for this fiscal year. There is another $8 billion to $9 billion of revenue in ADP that also experiences variability in retention.

But having said that to give you specifics around, you know, why our confidence level was high that things would get better and why it still remains high, we have a number of, in specifically the mid-market, issues that we were experiencing with rewards to retention. We have a lot of metrics, as you can imagine, that we look at that are leading indicators versus retention, which is a lagging indicator.

For example, the speed to answer phone calls, number of cases that are unresolved in a backlog, we have a number of escalations in terms of people escalating client service issues and the metrics are -- most of the metrics in the mid-market regarding service experience for our clients are either back to where they were prior to our retention issues or in some cases better. So we feel confident that even if there's some kind of lag in the sense that some clients may have already been in process due to a poor service experience of looking at alternatives, and the fact that there are other parts of ADP that have variability and retention as well, I think not withstanding all those things, I think my confidence in the improvements in service, stability, and service experience in the mid-market remain quite high actually.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

And if I add a more technical comment, relative to our losses that we see over the fiscal year, we have cyclicality in our loss volumes, and so year-end -- calendar year-end on the third quarter for us, fiscal year -- are traditionally higher loss months, and the fourth quarter month is a lower loss months. So hence, there can be variability in the quarterly shifts of the retention numbers, and this case it impacted a relatively low loss volume that we typically experience in the fourth quarter.

So my general council would be to observe those retention changes that we report, but not to get overly analytical and mathematical quarter-by-quarter. It is a better indicator to think about basically our retention number of 100 basis points decline. So in the fiscal year, in closing, we're aiming to be better. We don't guide to retention, but as you might imagine as a Company, we clearly have aspirations to improve.

Ashish Sabadra - *Deutsche Bank - Analyst*

Thank you. Thank you for the color.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Thank you.

Operator

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

David Grossman - *Stifel Nicolaus - Analyst*

Thank you. I wonder if I could ask a question about the margin guidance. I think you gave us some good color on what the headwinds were going to be into FY17, but if I understood you right, but if I understood you right there's about 20 basis points of incremental headwinds over and above what you're isolating as nonrecurring. Perhaps you could give us more insight in to, you know, what those incremental charges are, and when you bundle everything together, you know, as you come out of FY17, how should we look at how the model has changed and how the leverage in the model changes beyond FY17?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

So as we described, our initiative is really to create more concentrated centers of excellence and strategic locations, and we indicate basically five big cities that we're doing. So as a consequence, approximately 5% of our employee population is going to be transferring or moving or the work will be moving and impacting about 5% of our associate population in this fiscal year. And there are costs that are related to this which are, which we are non-GAAPing, which are related in essence to employee costs to facilitate the transfer of the work that is basically included in the 20 basis points of our guidance.

We clearly hope that the outcome of this service alignment initiative is multi-folded. I believe strongly it will enhance our service valuable proposition, because we're going to have larger centers with bigger capabilities, leveraging ADP's strength and compliance in service and offering a better value proposition to our clients, which is the most exciting part for this service alignment initiative. Hopefully resulting in better competitiveness and higher retention rates, and also as you can see, these centers are located in geographies of the US that offer certain advantages, relative to the cost where they operate, so that we should be in the longer run also contribution to our margins.

We're a little bit hesitant to specify this for 2018 because the initiative will actually bleed over in to FY18, we mentioned in particular the center and investors West is going to come later in 2017 and will bleed over 2018. So 2018 will still have some impact, but we're clearly hoping that it will guarantee basically that we can fulfill our commitment to the 50 to 75 basis points of margin expansion in the long run, so this is an important supporting initiative for that.

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

And David, I think to be -- I think you're right, the 20 basis points is above what we've put in quote, unquote the non-GAAP numbers. And I think, you know, that's just a frictional cost. They are identified. We know what those costs are, and they are costed. It's not appropriate to bucket into the non-GAAP charges, I guess is the best way to put it.

I'm not, obviously, the accountant, but I think your math is, or your comment was spot on. So that's the, when we provided that color to give you more information to be able to come up with what you might think might be the longer term potential performance of the Company, which as Jan said, we're optimistic about.

And I think we're doing these things, you know, really there's two things that we're always focused on: service experience, the client experience from our service organization, and implementation and just the operations of the organizational role, and our competitiveness and our efficiency. I would call this a large initiative and a complex initiative that hopefully is coming across with the significance that it should, and it's multi-year.

David Grossman - *Stifel Nicolaus - Analyst*

Thanks. And can I ask just one follow up on just the CapEx comment at well. So it sounds like CapEx is over $2 million related to this, so is there anything we should think differently about the year-over-year growth and pre-cashflow in FY17?

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

I'll let, maybe Jan can comment a little more on the CapEx. We weren't implying that the entire CapEx was because of this initiative. We have normal ongoing normal CapEx. It's just trending higher than it has historically. So wanted to make sure that we put that out there. But I do want to comment, besides Jan giving you the specifics on the numbers, that we are investing in this Company.

So this Company has an industry that has positive global dynamics in terms of growth. We just saw it with ACA in the US. We're going to see it with FLSA and the EEOC equity pay rules, and we're seeing the same thing in other countries. And so this Company has opportunity. And we intend to invest in order to seize those opportunities.

And so I think what you're seeing is our investment in CapEx, and frankly also our investment in capitalized software, which we disclosed but is not something that we necessarily always focus on, are all trending higher. And we take the deployment of capital very, very seriously as you know. But people should not mistake what our actions are for anything other than optimism about the future and the potential for these investments to have incremental returns for our shareholders over the long-term.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

I have really only two comments to add is, so there's a temporarily higher capital expenditure rate, and the increase is to the very largest amount driven by investments into our real estate project to get these facilities up and going. And related investments for this initiative.

And secondly, I'd like also to remind you that ADP has pursued over the last couple of years a growth strategy that is more focused on our organic growth capabilities, focusing on investments into our own product set and focusing in this initiative on enhancing and developing additional market-leading service capabilities. So I think it's right in line with how the strategy has worked for ADP, and it's really quite an exciting moment for ADP.

David Grossman - *Stifel Nicolaus - Analyst*

Very good, thank you.

Operator

Thank you. Our next question comes from the line of Rick Eccleston from Wells Fargo. Your line is open.

Rick Eccleston - *Wells Fargo Securities - Analyst*

Good morning. Thank you for taking my question. I wonder if we could go back on the new service initiative. Just kind of see if you could tie it in to the investments that you've made earlier in the delivery side, what informed this and how related or not was it to the service delivery issues and investments that you had earlier, and just tie those two together. Thank you.

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

So I'll make a comment, and then Jan I think can add. I really appreciate the question because they are, actually, quite separate topics. As though the service delivery issues that we experienced were concentrated in a particular part of our business in the mid-market, and they were execution related. And I think what we are talking about in terms of our new service alignment initiative is a broad strategic objective across the entire Company.

It's partly driven by the fact that the industry has evolved and I think the clients need to have evolved and the products have evolved. So as an example,10 years ago, having three or four different products that were serviced differently and different databases was not an issue. Our platforms now are single-database integrated solutions that provide an HCM solution if a client wants to buy it that way, in a comprehensive and seamless way.

The service model had not moved in the same direction. And I think that this initiative is really intended to have our service and implementation really align with the way the market is going, the way buyers are buying and the way clients want to be serviced.

So we've done similar things in our sales organization where that also requires that our sales force be trained and equipped to be able to sell in the new environment. So our belief is that now we will have our products, our service, and our distribution all aligned.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

And I think it is probably the best way to connect our focus on creating competitive technology platforms that are cloud-based and integrated as a prerequisite to create the integrated service model, so we have made really A, great progress with these strategic platforms, but B, also migrated now large numbers of clients on to these platforms. So it really does make good sense at this point in time to launch the service alignment initiative.

And as you might imagine, we did have, we have tested these service models and components of our organization at smaller scale. And we have seen great results out of those pilots.

Rick Eccleston - *Wells Fargo Securities - Analyst*

Thank you. Then if I could just quickly follow up, Jan, on the comment you made earlier about how you've been making more organic investments. Has anything changed just in general in terms of your portfolio shaping, any sort of divestitures, small ones to come, and how are you approaching M&A currently? Thank you.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

The, no I think our principal stand on M&A has not changed. We have a very solid balanced sheet, we have the capital to investment in the industry and we continue to evaluate opportunities, but we evaluate M&A opportunities in light of our strategic priorities, which is -- which are focused at this point in time on reduction of complexity and aligning and focus on our client needs.

So any acquisitions that support that drive, what we will actively and aggressively pursue. But it has played out over the last three years to a more organic growth pattern that has seen great results. And so I think that stand stays the same. I would not expect any dramatic shift in our attitude towards M&A, from what you have seen in the last three years.

And relative to divestitures and adjusting the portfolio, I think the large portfolio alignment initiatives have happened, with the spin off of CDK and I think our larger, last larger divestiture was advanced. There will be here and there smaller type of things as we continually to evaluate the performance of our product portfolio, and if we see opportunities to enhance shareholder value, we will pursue it as we have done so in the past. But it's really, in essence, I would anticipate FY17 to run under the same guide polls as in the last three years.

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

I think Jan's absolutely right on all those points. I would just add that back to the discussion about capital and the seriousness with which we take capital deployment, we do have a strong balance sheet so we have capital we can deploy. But as Jan said, you know, consumptionally if something really fit into our technology roadmap and accelerated our progress, we'd use our capital. But we're not going to use our capital to have something that, for lack of a better term, sits next to everything else that we have.

So it has to be able to be integrated rapidly and seamlessly into what we already are pursuing in terms of our product strategy. That's a little bit of a departure from, call it six, seven years ago when it was really more about leveraging our distribution and adding capabilities and products without as much, necessarily, regard to how they fit tightly into the technology road map.

And that's really not so much a change in strategy. It's a change in the market and the way people want to buy and the way products behave. Which makes it very, very important to have tight alignment and seamlessness in your products.

And then the last just factual comment I'll make to Jan's point, is we -- because we have capital, if something accelerated our progress, we would do it no different than we're doing some of these internal organic things that we're investing in to accelerate our progress. So if there's an external opportunity to use our capital, we would.

But the fact is that over the last couple years, when you look at the balance of capital deployment, Jan and I have this discussion all the time, we haven't consciously avoided doing acquisitions. It's just been harder to find ones that make sense and fit in what we're doing in terms of our strategy.

But net-net when you get down to it, we're spending, call it $300 million to $400 million less on acquisitions and we're spending more on things like internally developed products, capital expenditures and the investments that we 're talking about for FY17. So it wasn't necessarily planned that way, but it just so happens that, you know, we 're not necessarily deploying any more capital, but we 're just deploying it in a slightly different way.

But we do retain the right to deploy capital towards acquisitions as well.

Rick Eccleston - *Wells Fargo Securities - Analyst*

Thank you.

Operator

Thank you. Our next question comes from the line of Mark Marcon from Baird. Your line is open.

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

Good morning and thank you for taking my question. Just wondering if you could just add a little more color in terms of the service realignment, in terms of, you know, how clients may end up being serviced? Is it -- you know, is there going to be a transition to like a dedicated service rap for the mid-market? What did you see out of the pilot studies, and what's the -- what's the reaction internally, you know, with some of the service providers in terms of potentially geographically relocating?

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

It's a great question. We'll give you a little bit of color, and then maybe Jan can add in terms of what he's hearing out in the field. It's interesting the term dedicated reps, because we do have parts of our business, obviously in the up-market and national accounts, we have very specific people that service specific clients. And then when you get in the small business market, we tend to have a model where, you know, the execution and the delivery is very important, but the person that you reach is not as important.

We believe that's the right model. We believe our retention rates and our growth in the small business market prove that our model works as long as you execute well, and we would also argue that in today's world, having a dedicated rep who works eight hours a day might not be the best service model for a small company, or any other company.

So we prefer to focus on how -- what's the best way to deliver the best service to the client in the way they want it delivered. And it varies from small business up to the up-market in terms of whether you need a dedicated person or not. But I would encourage you to kind of visualize this service realignment as being more around teams rather than dedicated people, so having alignment around teams.

So as an example, given the attach rates that we've discussed over multiple quarters that we're experiencing now in the mid-market and in the up-market, around additional HCM modules -- in other words, clients are rarely buying just payroll by itself or just benefits administration by itself. So this service model really is intended to be able to provide a group of people or a team of people who work together, who are collocated, and can deliver service across the entire HCM spectrum. That obviously requires some cross-training, but also some ability for people who have special skills to be available and close to people who need to support our clients on a multiple number of issues.

So we have a reasonable amount of experience in experimenting with what we call intact teams or with collocated teams, and we feel good about the results when it comes to retention, when to comes to client satisfaction, and by the way in our business, when you have those two things, margin follows. So this is primarily led by quality and experience for the client, and also by the way, opportunity for our associates.

So what we have found also is in some of our subscale locations, there's very, very limited mobility and opportunity for associates to progress from a career standpoint. And we now have a number of opportunities across our business for people to learn new things and to move into different areas, whether it's time and attendance and pay roll, benefits administration, talent management, we really run the whole gamut on HCM, and we needs across the entire business, and when we have people scattered across the entire country in small subscale locations, it just doesn't I think make sense from a talent management standpoint for ourselves, internally either. And so on all those fronts, we think that this service alignment strategy makes sense.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Carlos mentioned most of the factors. I would add, too, we have seen a rise in our associate engagement scores as a consequence for those who work in those intact teams. And it reflects probably better of how in a modern team environment our associates want to work. So that's really exciting for our associates as well.

And one additional component that a strategic move on locations allows you to plan for is also a coordinated effort between our market segments, small, medium and large. So I think we mentioned it in the call. So now we have collocation between those market segments, and there can be natural growth and exchange of best practices between the different platforms.

And for some of the platforms, the back end is fairly similar. If you think about sender-self excellence for our tax filing operation and so forth, so it allows us also to create buckets of scale that are very hard to create in smaller locations. So it really, I believe, will transform of how associates be perceiving A, the value of the job they're in and the job opportunities then that can reach in the future and allows us to deliver additional service capabilities to our clients, which is the strategic benefit that we're reaping out of it.

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

Certainly seems to make a lot of sense. I applaud you for taking this long-term step. Can you talk also with regards to the expectation for new bookings growth, where you would expect to see the strongest growth in terms of which areas?

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, when -- I'll take this right on -- if you look at FY16, we had actually fairly balanced growth across the business. We had great performance really along all segments and continued strength in multinational, great performance really across all segments. Maybe the only spot that has been a little bit harder was Europe as you might imagine, and our best of breed solutions, but that was really more than balanced by good demand from multinational solutions.

So when we look at the plan, other than specific grow-over challenges that we had because ACA cells were concentrated in the mid-market and in the up-market. If you take that out it's really each of the business units continues with very good performance, and just as a reminder, it was $1.75 billion of recurring revenue that sales force generated for ADP, and even if the growth is a few percentage points slower, this kind of still a very significant number.

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

Terrific, thank you.

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

We have time for one more question.

Operator

Our last question for today will be coming from the line of Gary Bisbee from RBC. Your line is open.

Gary Bisbee - *RBC Capital Markets - Analyst*

Yes, thank you. Good morning. I wanted to go back to an earlier question, just around the concept of revenue acceleration. So you've had two years of above-trend bookings, you've got pace for control continuing to click along at a similar pace, you had a drag this year from selling a business that will no longer be a drag in 2017, and you know, retention was a drag, I guess you're not saying specifically. But maybe still a drag, but it sounds like a lesser one potentially in 2017.

So why don't -- you've always said the current-year bookings don't do a lot to revenue. Why wouldn't we see some acceleration? Is it as simple as PEO? You're calling for that to be slower? It just feels like there should be a bit better revenue growth from, you know, thinking through all these moving parts. Thank you.

Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, I think -- the math is how the math is going to work out between the starts that we have sold and the retention, and there's really no change in how we have built our business models over time. We did have a little bit of unusual revenue skewing that created the more revenue acceleration, I guess, in this year than for next year. Which contributes a little bit to the thing. But if you -- if you take that into account, there's really nothing that unusual in next year's revenue growth.

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

Yes, and I think that all the things you mentioned it's important to acknowledge what you said. We do, again even though we don't give specific guidance, we do expect less of a drag for example from retentions, because we expect things to get better. We have some metrics and some things underlying, I think, data that give us hope at least, right? Because we don't know for sure that will improve your math, the comments you made about new the business bookings, all those things are correct.

I think I would just encourage you to maybe spend some time offline with us in terms of kind of the math and how the revenue works. One of the interesting things about this business, this is an incredibly stable and predictable business model. It's also very, very hard to move the numbers dramatically one way or the other over the course of one year.

So over the course of four or five years, we've had double digit new business bookings and this year we had a blip with retention. But retention's also been fairly stable. That's allowed us to accelerate our revenue growth about 1/2 to 1 percentage point from, call it five years ago, in employer services.

The PEO, as you said, also happens to be a factor because it's growing faster and it's becoming a larger portion of the overall results. So if it slows slightly that has an impact, too. So we'll spend the time to make sure we do the math, but what I can tell you is that you're right, that this year, if you exclude the impact of the divestiture or if you don't factor the divestiture in, we were close to 9% revenue growth. We're really proud of that.

And next year we're slightly below that because there's one day less, because this year was a leap year or whatever the issues are, and we have a drag still from, even though retention's getting better, it's still not as good as it used to be. We're still going to be pretty damn happy and pretty damn proud, because we're going to be in I think still, in the high end of our guidance from a revenue standpoint. And in this business, when you get into that range, given who we are, in terms of because we understand, we have very keen insight into who we are, like as a company in terms of where we want to be, in terms of our growth rates and our margin improvement and the balance of those things, I think we're, I think satisfied with that outcome.

It obviously makes it easier as you pick up additional revenue growth because of the nice leverageability of our operating model. But, you know, that's part of why we're also doing some of the things we 're doing around service alignment, because we know that we're really not, I think satisfied with just the results that we have today. On the other hand, we're not going to sit here and tell you that we're trying to aim for 10%, 12%, 15% revenue growth because that's really not who we are.

So 7% to 9% is our long-term guidance for revenue growth, with some margin improvement, with a healthy dividend, with share buybacks, that's our model, that's what we're executing against. And I'm proud of the Organization and the results they delivered this year. And I think if we deliver the results that we've put out there for next year, we're going to be just as proud of that as well.

Gary Bisbee - *RBC Capital Markets - Analyst*

Okay, great. And then if I could add just one quick follow up. On the ACA product, how much of the revenue would be charged for sending out like the 1095 forms and what not versus -- I assume there's some ongoing revenue related to the analytics and compliance tool --

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Jan Siegmund - *Automatic Data Processing Inc - CFO*

Yes, this allows me to make another pitch for our fantastic and very differentiated ACA product. It is actually far more than just sending out 1095 and 1094 forms. It is really a compliance service that we offer, that ongoing offers -- ongoing monitoring and assessment services for eligibility and affordability. And also, which is really very differentiated in this market, offers what we call notice management services at the back-end to react to agency and exchange notices and keep the company in compliance with those, that's where a bulk of the fines can actually incur.

So we build our clients on a per-employee per month basis. So the revenue stream is actually not concentrated on a specific form delivery, it's an annualized recurring revenue. And so you should think about the revenues exactly the same way you think about the rest of ADP.

Gary Bisbee - *RBC Capital Markets - Analyst*

Great, thank you very much.

Operator

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

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

Thanks. This is our 67th year, and where we've combined world class operations with innovative products and services that meet the dynamic needs of our clients. This was never more evident than in 2016, and I'm proud of the success of our business in getting the solutions to market to meet those needs of the clients.

And if I can get on my soap box for a second, I mentioned previously that ADP -- this is ADP's 41st consecutive year of paying and increasing our dividend. And as a dividend aristocrat, ADP is one of just over 50 companies in the S&P 500 who have paid an increase of dividend for more than 25 years.

Now with some of the things we're talking about for FY17, ADP leaders and associates are making the investments to lay the foundation for ADP to join the dividend royals in nine years. And that's a list of just 17 companies who have paid and increased their dividend for more than 50 years. Any student of business knows that only the most durable and enduring icons of business make either list. This success is entirely attributable to the hard work and dedication of our associates, who commit themselves every day to ensuring our clients' success.

So to them, and to all before them, I say thank you. And I thank you all for joining the call today and for your interest in ADP.

Operator

Ladies and gentlemen, this now concludes today's conference. We appreciate your participation. You may now disconnect at this time. Everyone have a great day.