Automatic Data Processing, Inc.

Automatic Data Processing, Inc.	ADP	Q3 2014 Earnings Call	Apr. 30, 2014
Company▲	*Ticker▲*	*Event Type▲*	*Date▲*

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Carlos A. Rodriguez – President and Chief Executive Officer, Automatic Data Processing, Inc.
Jan Siegmund – Corporate Vice President and Chief Financial Officer, Automatic Data Processing, Inc.

Other Participants

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James MacDonald – Analyst, First Analysis Securities Corp.
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Automatic Data Processing third quarter 2014 earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Elena Charles, Vice President, Investor Relations. Please begin.

Elena S. Charles, Vice President, Investor Relations

Thank you and good morning. 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 fiscal 2014 earnings call and webcast.

Before discussing our financial results, Carlos and Jan will talk about the planned spinoff Dealer Services announced on April 10 and our latest human capital management technology innovations. Finally, after Jan discusses the quarterly results and the full-year forecast, he will provide his thoughts about the expected impact of our client funds investment strategy for fiscal 2015.

I'd like to remind everyone that during today's conference call, we will make some forward-looking statements that refer to future events and as such involve some risks, and these are discussed in our earnings release and in our periodic filings with the SEC.

With that, I'll now turn the call over to Carlos.

Carlos A. Rodriguez, President and Chief Executive Officer

Thank you, Elena. Good morning and thank you for joining us.

As Elena mentioned, we have several exciting topics to cover on our call. I'll begin with our strategic decision to spin off the Dealer Services business, a decision which we believe will benefit ADP shareholders by allowing each management team to focus on its respective industry. For ADP, this deepens our commitment to being a global leader in human capital management and positions us well for future growth. For Dealer Services, it allows them to focus on expanding their leadership position in the global automotive retail industry.

You might ask, why spin off Dealer Services now? The global retail automotive market is evolving at a fast pace, fueled by digital marketing and other innovations where Dealer Services currently enjoys a market-leading position. In addition, this industry is the strongest it has been since 2007, with U.S. vehicle sales continuing to recover to pre-crisis levels.

In separating the two companies, we expect Dealer Services to be a strong, independent company with solid growth prospects, a strong competitive market position, an experienced management team, and an aligned capital structure. We fully believe that this is the right decision at the right time for both companies and for the shareholders.

And now I'll turn the call over to Jan for his comments regarding the transaction.

Jan Siegmund, Corporate Vice President and Chief Financial Officer

Good morning, everyone.

As Carlos mentioned, we believe this transaction will better enable both ADP and Dealer Services to pursue their respective growth strategies and drive long-term shareholder value.

The structure of the transaction will be a 100% spinoff of the Dealer Services business into a separate, independent, publicly traded company. This will be a tax-free transaction for our shareholders. And we anticipate its completion in early October, subject of course to applicable regulatory requirements. We expect to file the initial Form 10 in early June and plan to have an investor road show with the management team of the new Dealer Services company as we get closer to the spin date.

Additionally, we will be looking carefully at costs as we create the appropriate public company infrastructure for Dealer Services. Although we will offset some of these costs within ADP's existing infrastructure, we expect there will be a moderate increase in expenses when looking across both companies.

As previously disclosed, we anticipate that ADP will receive at least $700 million from the Dealer Services business at the completion of this transaction, and our intent is to use this cash to repurchase shares of ADP stock subject to market conditions.

Regarding ADP's dividend, our intent following the spinoff is to increase the dividend annually, subject to board approval, keeping intact our 39-year track record of dividend increases. However, we expect to grow the dividend at a slower rate than earnings to allow us to return to our pre-separation target dividend payout ratio of 55% to 60% in about two years. Any dividend to be paid by the new Dealer Services public company will be determined about the Dealer Services Board of Directors and will be incremental to the ADP dividend.

Another area I would like to discuss with you is ADP's credit ratings, which were updated as a result of the announcement to spin off Dealer Services. We anticipated this change in ADP's credit ratings and fully contemplated it as part of our analysis. We are proud of our exceptionally strong AA credit ratings with a stable outlook from both Moody's and Standard & Poor's. In fact, you should note our ratings are still the best in our industry. The changed ratings are not expected to have any direct financial impact on our business. In addition, neither the spinoff of Dealer Services nor our updated credit ratings will change our disciplined approach to how we move more than $1 trillion in client funds each year.

And I now will turn back the call over to Carlos.

Carlos A. Rodriguez, President and Chief Executive Officer

Thank you, Jan.

We'll provide updates on future calls about the progress we're making towards separating the Dealer Services business from ADP. But once again, I believe that this is the right decision at the right time for both companies and for our shareholders. I'm excited for the future of both companies and especially pleased about the investments we are making in Employer Services to further establish ourselves as a leading global provider of human capital management solutions. So with that, let me share some highlights of how these investments are translating into our latest technology innovations.

Earlier this month, we held our annual ADP Meeting of the Minds Conference for our up-market clients. I'm pleased to say that we hosted more than 1,000 participants, where we previewed exciting work coming out of our ADP Innovation Labs.

Our next-generation user experience will transform the way that our clients' employees manage their work life through a host of new features that fully leverage tablet and smartphone capabilities. Today's employees expect easy-to-use technology that is similar to how they bank, use social media, book travel, and so much more. As a result, ADP's new user experience will set the industry standard, enabling employees and their managers to collaborate, perform key business functions more effectively, and in short, fully utilize the power of our HCM solutions in an intuitive yet powerful way.

What we previewed at our annual Meeting of the Minds provided a glimpse into innovations that increase the ability for employees to manage their work life, ranging from creating powerful pre and onboarding solutions that welcome new employees and leverage social media to get them productive more quickly, to finding the healthcare plan that best fits themselves and their families, easily viewing and managing their schedules, including social shift swapping, and transforming the traditional pay stub into a financial planning tool through real-time paycheck modeling that allows employees to immediately see how changes to withholding impact their pay. Of course, all these offerings will be device agnostic and available on tablets, mobile devices, PCs, and so forth.

We've built these innovations to be predictive by guiding employees through suggested HR selections, based on choices made by similar employees from within ADP's data-rich ecosystem. And we view this as just the beginning of how we can use data to help our clients and their employees make better decisions.

Our Meeting of the Minds participants were very excited about the product demos and also excited to know that the first rollout of this next-generation experience will be available in the early fall.

And now for some highlights on the quarter; ADP reported solid revenue growth of 7%. I'm especially pleased with the 14% growth in worldwide new business bookings for the quarter in Employer Services and PEO combined. This acceleration during the quarter was led by double-digit growth in the PEO, the mid-market, and our multinational solutions. We believe these results are evidence of our strong value proposition relating to ACA and compliance in the PEO as well as the competitive strength of our Workforce Now and multinational offerings.

Our up-market teams also experienced a good quarter, with new business bookings improving sequentially through the first three quarters. Vantage sales were also good this quarter, and we also sold a good number of Workforce Now deals in the lower end of national accounts. We are on track to achieve our new business bookings growth forecast for Employer Services and PEO combined of approximately 8% for the year, though we do have hard work ahead of us due to a tough grow-over comparison in the final quarter of the fiscal year.

Now moving on to PEO, as I mentioned a moment ago, new business bookings in the PEO were strong, and we continue to see positive momentum in this business. Growth in average worksite employees paid was a strong 18% for the quarter.

Moving on to Dealer Services, the global outlook for the automotive industry continues to be positive. Continental Europe is showing some signs of slow and gradual improvement, and U.S. auto sales continued to advance towards pre-recessionary levels. Dealer Services performed well in the quarter, as it continues to grow its client base with solid competitive win rates while also benefiting from increased digital advertising revenues.

And before I turn the call over to Jan, I want to update you on the progress we're making with migrating clients from our legacy platforms to our new cloud solutions. I'm pleased to report that migrations to ADP RUN continue to progress quite well. We have migrated over 20,000 clients during the quarter and now have almost 350,000 clients on this platform. We're on target to complete all small business migrations in fiscal 2015.

We are also executing on our plan to move all of our mid-sized clients to ADP Workforce Now. We currently have more than 47,000 clients on this platform. We are on our way to complete these migrations in fiscal 2015 as well.

We've been pleased with the upsell opportunities as a result of these migrations. Many of the clients we migrate to Workforce Now from a legacy standalone payroll platform sign up for one or more additional solutions such as time and attendance, HR and benefits administration, or talent. Additionally, we're seeing a notable improvement in retention rates for our clients on our newest platforms.

And with that, I will now give the call back to Jan for a look at the quarter's financial highlights and the full-year forecast.

Jan Siegmund, Corporate Vice President and Chief Financial Officer

Thank you, Carlos.

ADP reported 7% revenue growth for the quarter, which was nearly all organic. Focusing on continuing operations, we achieved 6% growth in both pre-tax and net earnings and 7% earnings per share growth on fewer shares outstanding compared with a year ago. The quarter's results were as anticipated in each of our business segments, performing well. Employer Services grew total revenue 6%. PEO grew 15%, and Dealer grew 7%.

In Employer Services, overall growth was good across the board. I do want to remind you that we anticipated slower revenue growth in Employer Services as we entered into the second half of this fiscal year as a result of lower revenues from our tax credit services business that helps our clients receive certain employment-related tax credits. These revenues were lower than a year ago because a program that began in last year's third fiscal quarter has expired and has not been renewed yet.

As many of you know, our third fiscal quarter is an important retention period in our business. And I am pleased that Employer Services worldwide client revenue retention increased 80 basis points, bringing us to a 10 basis point improvement on a year-to-date basis on top of historically high retention rates.

We are pleased to see continued strength in our same-store pays per control in Employer Services in the U.S., with an increase of 2.8%. However, in Europe, same-store pays per control declined 0.6%, as anticipated. Although the decline has lessened throughout the fiscal year, the economy across Europe is still mixed.

Average client fund balances were stronger than anticipated during the quarter, increasing 9%. Lower state unemployment tax rates were offset by increases from wage growth, including bonus payments by our clients, standalone tax filings, new business growth, especially in the small and mid-sized markets, as well as pays per control.

The PEO had a strong quarter with 15% revenue growth, driven by 18% average worksite employee growth and strong revenue retention.

Moving on to Dealer Services, revenue growth was 7%, driven by new business installed and digital advertising revenues. Margin improvement benefited from non-recurring items.

I would now like to take you through a few of the items that negatively impacted ADP's earnings growth and margin expansion in the quarter. The decrease in higher-margin revenues I spoke about a moment ago relating to certain employment tax credit programs we administer for our Employer Services clients also created year-over-year margin pressures. New bookings expense increased, as anticipated, from the strong bookings growth in the quarter. Higher-margin client fund interest revenues declined more than we anticipated due to lower interest rates. And the 10% increase in systems development and programming expense was higher than revenue growth and in line with our expectations. This increase is a result of our continued focus on innovation. Carlos gave some examples of these innovations in his opening remarks.

And before we leave the discussion on the quarter's results, I want to point out that the decline in client interest revenues resulting from low interest rates continues to be the most significant drag on ADP's results. ADP's revenue growth was muted almost 0.5 percentage point, as the lower yield more than offset the benefit from the 9% growth in balances. Pre-tax margin was negatively impacted 60 basis points, and diluted earnings per share was lower by almost $0.02 or two percentage points for the quarter. Excluding this impact, it is evident that the leverage in ADP's business model is strong and intact.

Now I will give you our updated full-year forecast, which excludes any one-time expenses in connection with the Dealer Services spinoff and the results of discontinued operations as shown in this morning's press release. We are now anticipating revenue growth of about 8% for total ADP. We continue to anticipate slight pre-tax margin improvement for total ADP from 18.8% last year, which excludes the goodwill impairment charge recorded in the fourth quarter of fiscal year 2013.

We expect the effective tax rate will be about flat with fiscal year 2013's effective tax rate of 33.9%. We anticipate about 9% growth in diluted earnings per share from continuing operations compared with the $2.88 in fiscal year 2013, which excluded the goodwill impairment charge recorded in the fourth quarter of fiscal year 2013.

As it is our normal practice, no further share buybacks are complemented in the forecast beyond anticipated dilution related to employee equity comp plans, though it is clearly our intent to continue to return excess cash to our shareholders depending on market conditions.

And for our segments, in Employer Services we continue to forecast revenue growth of about 7%, with pre-tax margin expansion of about 100 basis points. Consistent with our prior forecast, we are still anticipating an increase in our pays per control metric in the U.S. between 2% and 3%. For PEO Services, we are now forecasting about 14% revenue growth, with slight pre-tax margin expansion. We continue to forecast about 8% growth in the dollar value of ES and PEO worldwide new business bookings from the $1.35 billion sold in fiscal year 2013. And for Dealer Services, we continue to forecast about 8% revenue growth with about 100 basis points of pre-tax margin expansion.

We have narrowed our forecast for the client funds investment strategy, and the detail is available both in the press release and in the supplemental slides on our website, but I will provide the highlights. We anticipate client fund balances for fiscal year 2014 will be about $20.7 billion, which represents about 8% growth. We anticipate a yield on the client fund portfolio of about 1.8%, down about 40 basis points from fiscal year 2013. We anticipate a year-over-year decline in client funds interest of $45 million to $50 million and a decline of $55 million to $60 million for the total impact of the client funds investment strategy.

And now we also wanted to take a few minutes on the call today to talk with you about the expected impact of our client funds investment strategy on fiscal year 2015. Keeping in mind that we are still in our operating plan cycle and that these numbers are preliminary, our expectation is that the impact of the strategy to earnings will be about flat to fiscal year 2014; that is, neither adding to nor subtracting from earnings. Let me walk you through the slide to provide a way for you to think about this for the purposes of your models.

The chart on the left side of the slide should be familiar to most of you. Here we show the detail of our client funds available-for-sale portfolios as of March 31, 2014, including the balances and the embedded interest yield for the remainder of fiscal year 2014 and beyond. We included full-year fiscal year 2014 on this chart to give you some perspective on the rate pressure we continued to experience this year, with an average embedded yield of 4% for the maturing balances compared with this year's average reinvestment rate of about 1.8%.

For fiscal year 2015, based on current yield curves, we anticipate an average reinvestment rate of about 1.9%, which is still below the embedded rate of 2.7% for the securities that will mature during this fiscal year. This delta between the rates is not as wide as we have experienced over the past several years, and we believe that balance growth will help offset the rate pressure that we anticipate for fiscal year 2015.

For illustrative purposes, because our forecasts for next year are not yet completed, we are assuming an increase in average client fund balances of about 5%, which at this point in our operating plan process is reasonable. We therefore anticipated that the overall year-over-year impact in fiscal year 2015 from the client funds investment strategy will be about flat compared to the $55 million to $60 million drag we expect to experience this year.

And remember, the interest earned in our investment portfolio flows into two separate lines of the earnings statement. The chart on the left represents ADP's client funds available-for-sale portfolio.

The interest we earn on these portfolios is recorded as revenues on our earnings statement as interest on funds held for clients, with the exception of the interest earned from the extended portfolio on borrowing days, which is recorded as a portion of interest income on corporate funds within other income net. This is illustrated on the right-hand side of the slide. I hope this slide helps to make the point that both revenues and other income net are impacted by the client fund investment strategy for your modeling.

And before we take your questions, I want to state that although our share repurchases in the quarter were less than you may have anticipated, ADP remains committed to returning cash to shareholders. We repurchased 0.5 million ADP shares in the quarter for a total cost of $42 million because we did not repurchase shares for a period of time prior to the announcement of the Dealer Services spinoff. Our commitment to return excess cash to shareholders has not lessened as a result of the spinoff.

And I now turn it over to the operator to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And the first question is from David Togut of Evercore. Your line is open.

<Q – David Togut – Evercore Partners (Securities)>: Thank you. Good morning, Carlos, Jan, and Elena.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Good morning.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: Good morning.

<Q – David Togut – Evercore Partners (Securities)>: It looks like ADP had its best quarter in quite some time, if I look at all the leading metrics combined between client retention, new sales in ES and PEO, and pays per control growth in the U.S. You also seem to be on track for this transition to run for small business in Workforce Now for mid-market by year-end 2015. So my question is, putting all these factors together, are you setting the stage for a meaningful acceleration in revenue growth in ES once we get beyond FY 2014?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think first of all, the first part of your comments I think are correct that when you look at all the key metrics of our business, we're pretty pleased with the performance in the quarter. We obviously had some noise around this tax credit business and a couple of other items. But when you really look at the key metrics around retention, sales, and all the leading indicators, they really are very positive.

Having said that, in terms of acceleration of revenue growth, I would just remind – and I think you know this well that in a recurring revenue model, our ability to accelerate is really driven by the size of our sales number and what we're able to start from that sales number, with then subtracting what we lost for the year. So this improvement in retention and the acceleration in sales certainly accelerates our revenue growth. But a person's definition of meaningful acceleration in one business model versus in ours might be different.

So just putting it in perspective, if you look at all the components that drive our revenue growth over multiple years, I think we've given you these charts before. We have things like price increase, which is a small item, around 1%. We have pays per control growth, which is between 0.5% and 1%. We have some other noise factors, but the real key metric is what we call net new business, which is the difference between sales/starts and our losses. And we disclosed both of those numbers so you can back into what our loss number is and you can back into what our sales/starts number is. I think if you roll that sales number forward and apply a reasonable growth rate of call it 8% to 10%, which is what we've been guiding to over several years, and you assume that retention will improve slightly as it has been, which we're very happy with, you do see acceleration in revenue growth.

But I just want to temper the expectations with the sense that that math is very, very clear in terms of how it works. And what we've been doing for the last three or so years is adding anywhere between a $50 million to $100 million in incremental net new business. And so now, the difference between that start number and that loss number is somewhere between – let's just say it's between $500 million and $600 million. Right now, it's hovering around $600 million. If you assume a $10 billion business in Employer Services post-Dealer spin, than that gives you a sense of what's been happening to our organic growth rate, so it's been accelerating by somewhere between 0.5% and 1% over the last three years. I think if you roll through that math, I think it gives you some sense of the sensitivity around what we need to do in terms of sales results and loss results and retention in order to maintain that momentum of accelerating revenue growth.

I hope that helps because I think it should be a positive message that we have been accelerating revenue growth. We're bullish about continuing to do that based on what we're seeing around retention and sales, but I just want to make sure that we temper expectations.

<Q – David Togut – Evercore Partners (Securities)>: That was very helpful, thanks; just a quick follow-up on that point. Given your comment about rising client retention around the transition to RUN and Workforce Now and the message you had today on more innovation on the way, would you expect client retention to continue to increase over the next couple years and bolster this gradual acceleration, if you will, in ES organic revenue growth?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I happened to take a look at a chart of our retention last night over the last ten years. And you always have to have the caveat of the economy because, in our Small Business division in particular, the retention rate there is somewhat sensitive to economic changes. So I believe that during the last downturn, our retention rates decreased by about 1%, mostly driven by economic factors, by the economic cycle. And then those retention rates came back by roughly 1%; 1% – 1.2%, but close enough. And then in the last two or three years, we bounced around a little bit and now have had what appears to be three years of 10 to 20 basis point improvements.

When you look at our historical retention rate and how high they are across all the individual businesses and collectively, I would not factor in more than those types of modest improvements in retention because, even though as the clients have been migrated we've shown very good improvements in retention rates on those clients, again, just the way the math works, that in and of itself isn't alone to generate a call it 50 basis point improvement in retention year over year. Some of that is just related to the fact that some of our businesses are more sensitive to economic conditions, as an example, and we can't change economic conditions.

So we expect the retention improvements to continue to help in this growth rate and in our net new business, but I think prudence dictates that we're very, very careful because these retention rates we're at now are at record levels through multiple economic cycles, although obviously we're doing things through innovation, through migrations, and other things to hopefully continue to strengthen that retention. So that is clearly our hope and our expectation, but I would not be modeling more than what I would consider to be modest improvements in retention rates.

<Q – David Togut – Evercore Partners (Securities)>: That's very clear, thank you very much.

Operator: Thank you. The next question is from Smitti of Morgan Stanley. Your line is open.

<Q – Smitti Srethapramote – Morgan Stanley & Co. LLC>: Yes, thank you. Your SG&A looked very good this quarter and looks like it actually declined sequentially on an absolute basis. Does that have to do with the Dealer Services business that you sold off, or is there something else there?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: If you break down because we typically look at it in categories. So if you look at our sales expense, it was quite strong this quarter because of our good sales. But our sales results vary from quarter to quarter because there's some seasonality in sales results, and hence our sales expense will vary with that seasonality. If you look at our investments in R&D, as Jan mentioned, they were up about 10%, so that category was strong. So really in our core call it overhead expenses, I think that we have fairly good cost controls, but I think some of what you're seeing is really seasonality around sales expense and other factors because if you look at our expenses as a percent of revenue, they're pretty in line with what we've been trending at and we're happy with.

So we're, to be clear, trying to get operating leverage on our business through a variety of ways, including the migrations of our clients, which hopefully eventually will add operating leverage. We're adopting some continuous improvement initiatives to try to drive operating leverage as well. But our goal I think long term has been to grow our pre-tax operating earnings at a slightly faster rate, call it two to three percentage points faster than our revenue growth, which I think reflects slower growth in operating expense than in revenue. And that's of course holding all other things constant because the pressure that we've had from interest rates has made that difficult when you look at ADP's bottom line. But excluding the pressure from interest rates and other noise, that's really our objective, and I think the quarter is reflective of that.

<Q – Smitti Srethapramote – Morgan Stanley & Co. LLC>: Great, and maybe just a quick follow-up regarding the 14% growth in new business bookings. Can you help us parse out the growth in up-market versus down-market?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: So I think as we mentioned in our opening comments, we had really good improvement sequentially in what we call our National Accounts business. Up-market for us includes National Accounts but also includes some of our multinational solutions that we consider in that bucket of MNC. The overall category has shown really good sequential improvement. Unfortunately, as we've been very clear and transparent about, we had a very difficult first quarter on the heels of a blowout fourth quarter last fiscal year. And so we see improvement both in terms of units, in terms of dollars against previous year and against plan. So on every metric we see what we expected, which is a recovery as we rebuild our pipelines and we resolve some of our execution issues in our up-market business.

Having said that, the reason we're being cautious is that I just mentioned that part of our problem in the first quarter was our blowout fourth quarter last year, particularly in National Accounts, and we're now actually in the middle of the fourth quarter that now has to grow over that blowout fourth quarter. So we have a very, very difficult grow-over. But on a normalized basis, we feel that we've recovered in our up-market business and that the momentum is good.

We mentioned in our comments that our Vantage sales were up over the previous year, and I think we're pleased with. We also sold a number of Workforce Now deals in the low end of National Accounts, a large increase over the previous year. That's a strong, competitive offering against some competitors in the low end of our National Accounts business. So we think things are I think progressing as we expected and as we mentioned, which was a recovery that would take a couple of quarters as a result of rebuilding our pipelines and addressing our execution issues. But unfortunately, now we face a very difficult fourth quarter grow-over.

<Q – Smitti Srethapramote – Morgan Stanley & Co. LLC>: Thank you.

Operator: Thank you. The next question is from Jim MacDonald of First Analysis. Your line is open.

<Q – Jim MacDonald – First Analysis Securities Corp.>: Hey, good morning, guys. You talked about how Dealer would be free to pursue their new strategies as a standalone company. How about core ADP? What new strategies might you be able to do once you're separate a company and just focused on employer-type services?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think that this is really not about changing ADP's strategy, but about creating more focus on it. And so really we don't really have any ulterior motives or any other secret weapons at our disposal, other than obviously we have now more financial flexibility post-spinoff. Our desire and I think the board's view was that focusing my attention and my entire management team's attention on what we believe is a very large global opportunity in Human Capital Management was the appropriate thing to do. By the way, they thought the same thing about Dealer because they have a very capable, very experienced team there that has the same views about the retail automotive market that we have about Human Capital Management.

And so I think this is really about focus and about freeing up I think energy and attention of the two management teams. There really isn't any other – you shouldn't anticipate or expect a shift in direction here with the post-spin ADP. If anything, you're going to see a much more focused and I think determined competitor in the HCM world because ADP will be Employer Services and we will be HCM.

<Q – Jim MacDonald – First Analysis Securities Corp.>: And for my technical follow-up, PEO grew dramatically in the quarter, although it looks like you put on a lot of those employees late in the quarter. Can you talk a little bit about how that's panning out and if that had an impact on margins in the quarter, things like that?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: It did have an impact on margins because the – and I think the item you mentioned about the worksite employees coming on towards the end of the quarter, that happens every year, so that's a seasonal issue just because of what's called tax restarts and other factors in the PEO. So a large number of the new starts and sales and starts are actually equal to each other in the PEO business. That is very typical in that business.

The margin impact on the business was as a result of the PEO having those strong sales results. Obviously, our commission expense and our sales expense increase when we have very strong sales results, and the sales results were to say strong is an understatement in the quarter for the PEO, and hence our sales expense was quite strong as well or high. So that created a decrease in the PEO's margin versus the prior year, which obviously had some negative impact on ADP's margin for the quarter as well overall, so we're happy with that. Just let me add that we would love all of our businesses to have that much growth in sales because back to the very first question we got, that actually would accelerate revenue growth.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: And just a friendly reminder, of course. The accelerated growth of the PEO is also growing at a good clip our pass-through revenues in the PEO that are part of the PEO revenues. And those are no or low margin revenues that as a mechanical consequence also put margin pressure onto our overall ADP results.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: That's a great point. That's why I think to Jan's point, as you look at our 10-Q and you look at the comments we make to you, I think it's prudent to really look at the segment reporting as well as the overall ADP results for that very reason.

<Q – Jim MacDonald – First Analysis Securities Corp.>: Great, thanks.

Operator: Thank you. The next question is from Sara Gubins of Bank of America. Your line is open.

<Q – Sara Gubins – Bank of America Merrill Lynch>: Hi, thanks, good morning. Could you talk about how you're thinking about potential client migration for existing clients onto the Vantage platform? I know this hasn't been an area of focus, but I'm wondering if it might become more so.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: So it's a great question because we were with 1,000 clients just a few weeks ago at our Meeting of the Minds event, and we had the same question from a number of clients. We're doing two things to address that. One is that we are increasing our investment to increase our capacity to be able to do migrations, so we've done a few already. But clearly in theory, we have probably demand for hundreds of those types of migrations. So we're doing two things. One is investing in that capacity to make sure that we can do migrations at a pace that's responsive to our clients' needs or our clients' desires, and also to block competitors from trying to take business from us, which has been a very effective part of our migration strategy in the low end and the mid-market.

The second thing that we're doing besides adding capacity for migrations is we are making some what I would call modest investments from a technology and innovation standpoint on our existing enterprise platform, which we gave a preview of ADP at the Meeting of the Minds gathering. It was extremely well received because, frankly, in the up-market space, there are many clients who aren't necessarily – there are some that are lining up to migrate, and there are many that aren't because transitions can be disruptive, expensive, et cetera to their own business, and it may just not be one of their business priorities. So them seeing that we're willing to invest in the short to medium term in our enterprise platform to give them a lot of the same capabilities from a look and feel and experience standpoint that we're providing on Vantage was just very, very well received, so we're frankly excited about that. And we think that, I guess to put it bluntly, buys us time to be able to execute on these migrations to Vantage over the next several years.

<Q – Sara Gubins – Bank of America Merrill Lynch>: Great, thanks. And then just as a follow-up, are you seeing any change in the pricing environment? I'm wondering. When you lose clients to competitors, is pricing ever being given as the reason?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Yes, definitely. We track, obviously, very carefully where our clients go in terms of losses and then the reason codes, whether they're related to service or product issues in terms of feature functionality or price, et cetera. Again, we look at those numbers literally every month very, very carefully. And we really haven't seen – other than right after the economic downturn. So going into the economic downturn there was a very large increase in price reasons for clients terminating. And then once we came out of the economic downturn, that went down as a reason, and now it's been stable. We really don't see any major – and part of it is probably just because of our size because it's a large sample. But there's really nothing exciting to report. I don't know if Jan has anything to add, but it just doesn't seem like there's anything there in terms of changes.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: No, Carlos is exactly right. The mix of factors that clients indicate when they leave ADP has been stable, and also our discounting in new sales has been stable. So the pricing environment has been overall stable for a number of quarters and a couple of years I would even say. The net impact is that we are realizing about 1% of revenue growth through price increases on prices overall and new businesses coming in at typical rates and really a very stable pricing environment.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Let me just add that part of our approach around HCM is not necessarily to try to drive price at the individual payroll level, but it's really to add additional solutions that we think help our clients solve business problems and help them manage their people better, but also frankly create more revenue for us. We gave you examples. For example, as we migrate clients and even as we sell new clients, the typical attach rates in terms of the number of modules that we sell is definitely higher than in our legacy client base. I think that helps us a lot from a "pricing standpoint" if you consider pricing to be unit-based. But it's not really pricing per se and it's not a competitive issue in terms of making us uncompetitive because what we're doing is we're selling more things and more solutions than just getting higher dollars per client or per unit. So that's our preference from a pricing standpoint rather than trying to drive price increase, if you will.

<Q – Sara Gubins – Bank of America Merrill Lynch>: Great, thanks a lot.

Operator: Thank you. And the next question is from Gary Bisbee of Royal Bank of Canada. Your line is open.

<Q – Gary Bisbee – RBC Capital Markets LLC>: Hi, good morning, and I should say congratulations on the decision to spin the Dealer business. I guess on that topic, can you give us an update within the Dealer business? What's the mix of the core DMS software offering versus digital marketing? And how should we think about what's been going on in terms of growth rates in those two parts of the business and how the profitability differs from one to the other?

<A – Jan Siegmund – Automatic Data Processing, Inc.>: Gary, at this point in time, we're really not updating more and publicizing more detail about the revenue mix and growth rates. We leave that to the filing and then the road show as we prepare Dealer Services. You're aware that Dealer Services has three components – or two components really of major businesses. That's the traditional Dealer Management Systems business. That's the core of Dealer Services. And we added through the acquisition of Cobalt a meaningful business to the digital marketing capabilities. Those are the two major businesses that one should think about Dealer Services. And you will see probably end of May, beginning of June when we file, you will see the segment reporting.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think just to help a little bit, I think there were some public comments or filings about the revenues of Cobalt at the time of the acquisition. I think if you apply a reasonable growth rate to those, you'll get close to what you're looking for in terms of the mix. But I think as Jan said, we're obviously going to be providing a lot more detail.

<Q – Gary Bisbee – RBC Capital Markets LLC>: How about just higher level commentary? When we try to think about the cash flow generation of the HR businesses relative to Dealer capital spending levels or tax rate, but it's probably too early on that one. Can you give us just a high-level thought? Are the businesses similar? Is one much better, one worse on capital efficiency, cash flow generation? Any other commentary on that would be great.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think both businesses are exceptional in terms of their profile around capital usage on a normal ongoing basis, if you will. So the only factor that would change that equation is really what I would call voluntary decisions about acquisitions. But if you look at the businesses in terms of their need for capital, they're very, very similar. Even though the Dealer Services business has some nuances in a couple of areas in terms of our international business having a little bit more licensing fees versus recurring revenues, but when you really put it all together, the businesses are very, very similar, which is why we've held this business for so long and why it's been so good to us. We share a lot of DNA.

Even though they're different industries and one is very focused on automotive retail and the other one is HCM, which is part of why we're making the separation, the separation is not because of the underlying dynamics or performance of either business because the Dealer business has been performing quite well. So to put it I guess in plain English, I think the cash flow generation capability of Dealer on a relative basis is almost the same as Employer Services, very low capital expenditure requirement, very good margin, which by the way is very similar to the overall ADP margin. So if you start off with "net income" and you add back depreciation and amortization and you go through all the normal working capital changes, I think you're going to see, on a smaller scale, obviously, adjusted for size, a very, very similar picture in terms of cash flow generation capability.

Then the decision comes down to do you do other things like capital expenditures that can utilize I think capital more or less. And again, over the years, we've had times where Dealer has made a number of acquisitions. There are other times where Employer Services has made a number of acquisitions. So that part is a little bit harder to pin down, but that's going to be up to the Dealer Services management team and their Board of Directors.

<Q – Gary Bisbee – RBC Capital Markets LLC>: Great. And then the follow-up question, you talked an awful lot about the new platforms across RUN and Workforce Now and Vantage. You haven't talked a lot about changes in technology and platform within the PEO business. Obviously, that continues to be a terrific grower. But can you give us just a high-level sense of how that's evolved over time and if the offerings within the bundled solution there have changed a lot in recent years? And ultimately, I'm just trying to think through the continued competitiveness of that business. Thank you.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Very good question that Jan asked me about a year ago. As we talked about modernizing and migrating and so forth, the PEO has really been using the same underlying platform for a while now. The difference with the PEO or perhaps why it may not be – it's important why we're in a slightly different place is the co-employment model creates a different level of touch point with the client in the sense that we're highly engaged in the client's HR decisions. We're highly engaged in their benefits decisions, not just the technology but in the decisions themselves. We actually provide them the insurance products around workers compensation and healthcare, so it's just a much broader, bigger relationship.

Having said all that, the employees of the clients in the PEO, which are now obviously over 300,000, have the same desire to have the same experience they have with their online banking. We mentioned that in our opening comments that the consumer experience at the employee level is still important and even at the practitioner level. So in response to that, even though we haven't changed the fundamental underlying platform itself, we have made some fairly significant improvements and investments in the user experience both at the worksite employee level and at the practitioner level. We saw a demo of that in one of my staff meetings just a few months ago, and it was quite, quite impressive, particularly around items related to healthcare reform and ACA. They're probably on the leading edge of providing tools to both the clients and to the employees to deal with the new regulations and to actually comply with those regulations.

<Q – Gary Bisbee – RBC Capital Markets LLC>: Thank you.

Operator: Thank you. And the next question is from David Grossmann of Stifel Financial. Your line is open.

<Q – David Grossman – Stifel, Nicolaus & Co., Inc.>: Thank you. Carlos, if you look back over time, that AAA rating had been an important element. Maybe important is an overstatement, but an element of ADP's branding. And I assume there were both advantages and constraints imposed on your business as a result of that. Can you help us better understand what the tradeoff, if any, is as you move forward as you think about the change in rating in terms of both positives and negatives that may be an outcome of that?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I'll give you a couple thoughts, and then I'll let Jan take a crack at it. He's done a very effective job in communicating with our external constituents about that topic, so he has given a lot of thought and talked to a lot of people about it as well.

To be clear, and I think Jan has made this clear as well, obviously, we were aware that we were going to have a potential change in our rating as a result of what we consider to be a strategic decision. Over the years, we have come across other strategic opportunities, for example, whether they be acquisitions that – we've never looked at large multiyear dilutive acquisitions. But when you look at a larger acquisition, even if it's in the HCM space, it requires taking on a modest amount of debt, that would have also led to a change in ratings. We've had those discussions over the course of several years, and always came to the conclusion and the board I think recommended that we not discard our credit rating for the sake of discarding it because we were proud of it and we enjoyed the publicity, if you will, of being one of four AAA-rated companies.

Having said that, the board and my predecessor and his predecessor and everyone were always very clear with you and with everyone that for the right strategic transaction, we didn't believe that it was worth not doing a strategic transaction in order to preserve AAA rating because it was largely a source of pride and not a source of financial advantage. So there's no change in our – we obviously don't have any debt, so it doesn't change our borrowing costs. And even if we do borrow at some point in the future, at least today the cost difference between AAA and AA is non-existent.

And so when you look at the full picture together, it was not a decision that we took lightly. It was a decision that we obviously thought about a lot and spoke with the board about. Jan and I spent a lot of time discussing that this was the right thing to do because we think it's the right thing to do long term for ADP and for Dealer Services. And at least so far, our expectation has been proven out, which is that we're managing really a public relations issue rather than a financial or a real issue because it has no impact on our business when you really get down to it other than potentially a positive impact of creating more financial flexibility for us down the road. Jan, I don't know if you have anything to add.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: I think you've covered really the vast majority of it. After the spin, we did a survey of our sales force and inquired about the potential client reaction impact, and there was none. Really even the public relations impact from being "downgraded" was non-existent from what our sales force experienced. So I think overall the outcome for ADP is a better space, more financial flexibility for us strategically in the future and our business model being intact for all the things that we need to do relative to the client fund and money movement operations, where credit rating does play a role, and the AA is a perfectly wonderful rating for that. We monetized or opportunity here I think in a good way.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: And I think you also should hear, as you have seen, that our commitment to our fortress balance sheet has not changed. And so even though we have more financial flexibility going forward, part of what we represent in terms of our industry is really we're still highly differentiated in terms of our ability to move more than $1.4 trillion through our money movement systems. The importance of credibility, the importance of the relationships we have with tax agencies and with the IRS, these are all very, very important things to us that we're never going to compromise on.

So the credit rating is one thing, but I think our commitment to our financial principles and how we run our company in order to be able to make good on all these commitments to both our clients and also to all the agencies that we work with has obviously not changed. And again, competitively, if I were one of our competitors, this would not be one of the items I would focus on in the sales call because, obviously, we welcome those discussions either at AAA or AA any day.

<Q – David Grossman – Stifel, Nicolaus & Co., Inc.>: Understood, thank you for that. I know that this has come up in a couple of other questions, but the PEO obviously saw significant growth in both revenue and worksite employees. You've talked about the Affordable Care Act in the past and that potential impact on the business and weren't quite sure how that would exactly play out. But do you have any better insight into what are some of the specific drivers right now that are creating some acceleration and growth in that business?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: The PEO really acts as a – and always has, so this is nothing different, acts as a large employer for the purposes of healthcare and workers compensation. And that's part of the value proposition is that you create scale in purchasing, in distribution, and administration of a lot of services, so not just HR services and benefits administration and payroll, but also on the products themselves, the healthcare and the workers compensation. So that has been the formula since ADP has been in the PEO business, so that has not changed.

Acting as a large employer while providing healthcare benefits to what are really client employees, if you will, at a sublevel, we have thousands of clients obviously that are part of our PEO business, creates an advantage, if you will, from a purchasing standpoint because our cost of healthcare we're purchasing on a large scale and as a large employer vis-à-vis small businesses having to purchase individual small business policies. So there has always been some theoretical advantage because there are also other drivers that drive cost of healthcare like your experience. Do you have high losses? Do you have low losses, the demographics of the age and makeup of the workforce. So there are lots of other factors that drive the cost of healthcare as well. But this issue around buying either as a large employer or a small employer has always been a factor, but it's been magnified by healthcare reform as new regulations and new rules have been imposed and new price controls have been imposed on small business policies and small business pricing.

So that's really where some of the competitive differentiation for the PEO I think has come from or has improved. But again, we're very proud and we're very happy with the acceleration. There's no question there has been an acceleration. But I just want to point out that this business has been performing well for a decade and has had double-digit worksite employee growth in the past as a result of the same factors that we're talking about today, but clearly they've been amplified as a result of healthcare reform.

<Q – David Grossman – Stifel, Nicolaus & Co., Inc.>: Thank you. Perhaps if I could just get one more in, you brought up the idea that you were working on expanding capacity for conversions. Could you just perhaps elaborate on how that impacts the competitive dynamic in retention? I think you mentioned that. I was just hoping to clarify that quickly.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think I was speaking really about the up-market space, and I think it was in reaction to a question about we're making progress on the low end, on the mid-market. And I think someone was asking about what about the up-market since we were not talking about that a lot. And so as a reaction really to the question about the up-market, we have very large investments in our up-market migrations already as we've been for several years moving clients from one version of Enterprise to our latest version of Enterprise. And I was really only alluding to the fact that as a result of demand that we've heard from clients, both at Meeting of the Minds and otherwise, that we feel that we need to expand that capacity to be able to migrate clients not just to new versions of Enterprise but also to Vantage. I wish I had more detail to report on that, but I don't think you should expect any – this was not intended as a major announcement competitively. This was about just modest increases in our already significant capacity in National Accounts to migrate clients, so we can also migrate some Vantage clients as well.

<Q – David Grossman – Stifel, Nicolaus & Co., Inc.>: Very good, thank you.

Operator: Thank you, and the next question is from George Mihalos of Credit Suisse. Your line is open.

<Q – George Mihalos – Credit Suisse Securities (USA) LLC (Broker)>: Hi, guys, thanks for taking my question and congratulations on the quarter. Carlos, you mentioned an opportunity to upsell or cross-sell clients as you convert them to the newer platforms and increase the revenue per client. Is there a way we can think about that across the different segments? Is it X number of modules that you generally have on the legacy platform, and now with the transition it's increased by two or three modules or maybe a 3% or 4% or 5% increase in revenue per client, any color you can provide there?

<A – Jan Siegmund – Automatic Data Processing, Inc.>: Yes, I'll answer this. The newest example we can give is for mid-market migrations of clients migrating onto Workforce Now platforms. And I think I talked about in prior calls about it. We have seen really two sources of improvements. Number one is clients buying in the process of converting and clients staying longer. It's a second source of improvement of lifetime value of the client, if you like. And the numbers have been now fairly stable over the last few quarters, so I think I can be pretty precise with you, where about 30% of clients that convert buy additional modules, about a third of the clients, so to speak. It happens within the timeframe of the migration plus/minus a couple months or so. And when they do so, the overall revenue base of our migrated clients is about 15% higher than it was before. The clients have several percentage points of retention improvement compared to the old platform that they were on, which is lower than the average of our clients. So you see really driving about 15% more revenue, 30% of the clients choose, and the condition improving.

<Q – George Mihalos – Credit Suisse Securities (USA) LLC (Broker)>: Okay, that's helpful. Is it safe to assume that the impact from RUN is somewhat lower than that?

<A – Jan Siegmund – Automatic Data Processing, Inc.>: Yes, it is because the most important loss driver for RUN is still down-market out-of-business and general economic reasons. So you'll see the retention we have not seen – we have seen retention improving in SBS gradually, and certainly RUN is contributing to that, but it's not as pronounced as we have seen it in the mid-market. We have a fairly stable mix of HR components that we cross-sell into the businesses, and I would more describe it that we had that for a while. You could buy EasyPay on the legacy platform with richer HR bundles before, and you can do that on RUN too. And I believe we have a mix of clients that are already optimally penetrated, so to speak, because not all clients need really more comprehensive HR solutions if you're a one or two-person company. You may not want to choose that. So the mix in the down-market we feel is already very good. So we didn't see missed upsell opportunities, so to speak. So we think of the RUN conversion as more revenue neutral.

<Q – George Mihalos – Credit Suisse Securities (USA) LLC (Broker)>: Okay, that's helpful, and then just last question. You guys spoke about some more flexibility on the financial side post the Dealer spin. Does that change your attitude towards employing debt on the balance sheet, and does that change at all your thoughts around the pace of M&A or the size of potential M&A transactions? Thank you.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I think, again, given the discussions we've had with our board over the last several years, I think the answer to that has to be no because we've never felt constrained. It's also not fair to say that it's a non-issue or a non-event because of the distractions. So we've had the AAA, if you will, monkey on our back, although we were very happy to have it, but it was a monkey on our back. And it was something that came up as a result of discussions around strategic transactions, be they slightly larger acquisitions that required employing a little bit of debt or just employing debt as a way of optimizing the capital structure of the company.

So it's just not fair. Again, I'm obviously in those discussions, and it's just never been a constraint. If we felt that there was something like we just did with Dealer Services that would add value long term to ADP, the board was always willing to do it. Having said all that, I think the reason I say more financial flexibility is I don't know if it's a 5% or 10% increase in flexibility, but there's some improvement in flexibility because there's really going to not be that obstacle, if you will, of that monkey being on our back anymore.

Operator: Thank you, and the next question is from Jason Kupferberg from Jefferies. Your line is open.

<Q – Ryan Cary – Jefferies LLC>: Hi, guys. This is Ryan Cary calling in for Jason. I hate to beat a dead horse on PEO growth, but obviously it's accelerated the past four quarters. I just want to be clear. Are you actually taking share, or is something really happening to the market that's just increasing the overall size of the pie?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: That industry is very difficult to get good reliable data on because there are only – I think now there are a couple public companies. There used to be only one, so it is difficult. There is an association that provides some data. I think based on what we see from the industry association and based on other information that we have, we believe we're gaining market share.

<Q – Ryan Cary – Jefferies LLC>: Okay, great. And just quickly, I know we're running over here a little bit. I don't believe you have any exposure to Russia and Ukraine. I just wanted to double-check on that. And I'd also love just a little more commentary on Europe and the climate. I know it's been a drag the last couple quarters. I believe it improved modestly this quarter, but just your thoughts on the outlook.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: So we have no exposure to Russia and the Ukraine. The European business environment has been more difficult for us compared to the U.S. Just a reminder, there's still revenue growth in Europe. It's just below the average of ADP's growth. So we have seen an ever so slight improvement in this pays per control metric quarter over quarter in a couple of countries. And those are the countries that you hear in the press are improving. We see that the same way, Germany and the UK and we're having a better year in France. So we see slight improvements, but the pays per control are still declining. So it is a relative easing of the pressure that we see. We continue to enjoy good retention rates in this market, and so it is just that slow growth environment. We anticipated the question around the international economic environment, and there's really just a gradual ever so slight improvement that we wanted to communicate. I don't think it's a great change, but it's a change that we are seeing at this point in time.

<Q – Ryan Cary – Jefferies LLC>: Great. I appreciate the color. Thanks.

Operator: Thank you. The next question is from Matthew O'Neill of CLSA. Your line is open.

<Q – Matt O'Neill – CLSA Americas LLC>: Hi, good morning, everybody. I had a quick question following up. I know we talked a lot about retention this morning. I was curious. Do you guys look at retention or think about retention as having a theoretical maximum that's actually below 100%, which you discussed this morning being attributable to the economy here and business consolidations or things like that as far as a target that you work for towards getting your clients at 100% satisfaction, and what is unfortunately lost that's completely out of your control? I was wondering if you could discuss that.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Sure, and we'll prepare for the next time to have more detail around actual numbers. But clearly, given everything we've said, the theoretical maximum is not 100%. I'll use an example. In the down-market, I think Jan alluded to it. In the low end, approximately half of our losses are really related to companies just going out of business. So you've seen all of the stories in the publications about how the amount of turnover in small businesses is quite high, which is just part of the way America works. People start businesses, and many of them fail and many of them are successful. And so there's a good close to 10 percentage points of losses in that low end, between eight and ten percentage points of losses that are what we call uncontrollable, where either bankruptcy or they just stopped processing because they go out of business and they just close down. Some of these are not even formal bankruptcies because they're sole proprietorships and they just stop doing whatever services they are doing. So that alone, the SBS theoretical maximum being somewhere in the low

90s% at best, obviously, factors into ADP's overall ability to achieve 100%. That obviously brings it down to somewhere lower than 100%. I don't know if it's 97% or 98%, but we'll do the math and get that for you.

And then in the mid-market, you have the same phenomenon but on a much smaller scale obviously. There's some number of companies in the mid-market that are uncontrollable losses, bankruptcy, out of business, but it's a smaller number because there, those are clients that are between 50 and 1,000 employees, and the level of failure rate in that segment of the market is much, much lower than in the low end of the market.

And you get into National Accounts, and there you have obviously almost no failures, but you still have things that we consider to be somewhat uncontrollable like, for example, consolidations. So a large national account client buys another national account client. If that client that's the acquirer happens to be an ADP client, it's a happy day for us because we get a new client as a result of the acquisition. If it's not an ADP client, then we have to go into a sales cycle. We have to go convince the acquirer to give us both combined companies rather than just the company that's being acquired.

And so we'll get more detail, more color for you. But clearly the theoretical maximum is not 100%, and it varies between eight to ten percentage points of uncontrollable losses in small business to probably somewhere between zero and 3% in our National Accounts business, and the mid-market is obviously somewhere in between. But having said all that, it's very clear to us because we look at this data very, very carefully. But without having done the math specifically for you, we have a lot of room to improve retention still that's controllable for us. The reason we're cautious and careful about expectations is you have to do a lot of – you have to improve your products. They have to be easier to use. You have to have better service. You have to be competitive on price. There are a lot of factors that go into driving that number up, and it's not one simple lever that all of a sudden is going to generate another 100 basis point improvement in retention.

The reason we say that with confidence is that we have, unfortunately, years and years of history that tells us to be careful and cautious about from here today how much room we have in terms of additional improvement in retention. But believe me, we're driving towards that. We're happy with the quarter. We're happy with the year. And we hope we keep getting it because it helps a lot with our growth rate.

<Q – Matt O'Neill – CLSA Americas LLC>: Thank you very much.

Operator: Thank you. The next question is from Tien-tsin Huang from JPMorgan. Your line is open.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: Hi, thanks. Good morning. I guess I just wanted to ask on the – maybe I'll start with the SaaS payroll question. A couple new companies have gone public. I know there have been a lot of PEO questions. But just on SaaS, given how those stocks are trading, I'm curious if that changes your appetite to acquire similar players or similar technologies.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: We're pretty happy with our own technologies, as you probably can tell.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: Yes.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Certainly on our new platforms. So no, it doesn't. Again, we're always open to using our capital for the best interest of our shareholders, including acquisitions. But we don't have a compelling need right now to buy technology or to buy platforms. We have a compelling need to accelerate our migrations and to sell more of what we already have.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: Okay, I figured that was the case. I just wanted to make sure, Carlos. And then just for Jan, I just wanted to clarify on the guidance. You moved to the high end of the revenue range but to the midpoint of EPS. Is the difference just the discontinued operations, or is it also the slower buyback and the rate outlook change? Thanks.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: No, the guidance does not contemplate the buybacks, the incremental buybacks above dilution.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: That's what I thought.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: And the guidance also excludes the disc-ops as well as the one-time cost that we anticipate in the fourth quarter for the Dealer spin. So this is really the true continued operations number that we guide towards.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: Right. So you're just a little bit firmer, I guess, just on earnings.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: As we progress through the year and we have really only a quarter left, we felt it was the true disclosure narrowed our guidance to what we see now to be appropriate to help you guys a little bit.

<Q – Tien-tsin Huang – JPMorgan Securities LLC>: Okay, I just wanted to make sure. Thank you, that's all I had.

Operator: Thank you. The next question is from Mark Marcon of Robert W. Baird. Your line is open.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: Good morning. I was wondering if you could just discuss a little bit more about what was truly exciting at the Meeting of the Minds conference in terms of feature functionality with regards to the improvements in Vantage. And how quickly will those be available broadly.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: So we just recently had a recent release of Vantage that I think had some great enhancements done up from a feature functionality standpoint. But the really exciting part at Meeting of the Minds was sharing the new user experience, which the ADP Innovation Labs folks that we now have working out of New York City obviously have made – and also here in Roseland, New Jersey have obviously contributed to that. We did, which again is different for us, we did an onstage demo that Mike Capone and Mark Benjamin did for all of the clients and some prospects of what that new user experience was going to be. And as we mentioned in our comments, it's going to be available in the early fall.

And that really was probably the most exciting part of the meeting because it showed not only our commitment to usability and user experience both at the practitioner level but also at the employee level because now we have more employees of our clients touching our products than we have clients and practitioners just because of the nature of how our business has changed. And so I think the clients and prospects see that as a huge positive because it relieves them of administrative work if people can easily and intuitively handle all of their HR administrative needs and, by the way, do some things that help them in terms of managing their own work life.

For example, in the demo it showed how someone can go through an open enrollment to choose their benefits and how, because we have payroll information and time information because we have the entire HCM platform, how on a single screen on one dashboard the employee can see how a change in their healthcare choices affects their take-home pay, affects their taxes, affects all other aspects of their work life, if you will.

So I personally thought that that was the most exciting moment where I think we got the most buzz is when people saw we're really committed to this technology innovation from a user experience standpoint because I believe that from a feature functionality standpoint that we already are pretty robust in terms of being able to deliver solutions around tax compliance and all the regulatory challenges that our clients experience, and we've been doing that for a very long time.

<A – Jan Siegmund – Automatic Data Processing, Inc.>: I'd add one component to it; that the user experience now includes also the leverage of our data. So not only the scope of the products that we are able to integrate into the user experience, but also the size and number of companies that we can include and offer now benchmarks and advice to either employees or managers on how to make their decisions. So we're really leveraging our data analytics in a very practical and intuitive way to the benefit of the employee. So we're trying to build really what we've been talking for the last couple of years, sources of data. Our social capabilities is a source that we have so many employees on our platforms, and translating it into very tangible values that you experience when you are on our platforms.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: It's a brighter visual since Jan gets more excited about it. As I remember the moment, not only does the employee see the impact on the change on their paycheck right away and can do what-ifs, if you will, on the screen, but to Jan's point, as they're choosing the different healthcare plans, our data actually will recommend to them or will tell them back to using social and use Amazon-like ratings, if you will, it will say the majority of the employees in your situation at your pay level with your number of dependents picked this health plan. There are these other two or three choices, but this is the one that is most often chosen. And by the way, here are the ratings from other employees of multiple companies of these different healthcare plans. So it's a very, very powerful, I think, use of data and analytics.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: That sounds like a very material improvement. As we think about just the fourth quarter new sales and you have this big grow-over target, is there a possibility that some clients will hold off on making any decisions and just wait until this is broadly available?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: That's really not our intention. It's not what has been our historical experience. Our salespeople obviously have been through this before...

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: Sure.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: ...where we have new product rollouts and we have enhancements to our products. So in our large account business, these cycles are very long sales cycles. And so people typically don't stop making decisions or don't start making decisions because of specific product feature functionality or technology available, and it's not been I think our prior experience. We didn't see that in this quarter. Obviously, our sales were very strong. We don't expect that to be the case because we have I think, obviously, incentives in place both for our sales folks but also for our clients because we want to get, obviously, them contracted as soon as possible.

When we implement them or when we start them, we today, for example, would be happy to sell a national account client for a fall implementation or even a January 1 implementation because that sales cycle takes that long. So frankly, given the timing of the announcement, I don't think it has any impact on our sales in terms of slowing our sales. That wasn't the intention. It was intended to actually accelerate our sales.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: Great. And then, with regards to WOTC [Work Opportunity Tax Credit], how much was that impact?

<A – Jan Siegmund – Automatic Data Processing, Inc.>: There was the impact. I think it's a little – I would say maybe half a basis – 50 basis points or so roughly.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: 50 bps, okay, great. And then with regards to just gaining share on the PEO side, what's the primary driver do you think that's driving the share gains?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Frankly, based on the data that I see, excluding acquisitions, we've been gaining market share for ten years.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: I know. I'm one of the few people who follow the other competitor. What do you think is driving it at an accelerating rate right now?

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Just to be clear, I'm not picking on one competitor because I was not referring to any one competitor. I'm talking about the entire – as I look at the entire industry, there are plenty of other competitors, and there's a lot of acquisition activity and a lot of available data, even though most of them are private. And my comment was I think was across the board, not on a specific competitor. But I wish I could tell you more other than clearly they're getting some help from the concerns people have around ACA and healthcare reform.

But also again, my personal view is that the business is executing really well. They've done some really great and innovative things even on the sales side over the last two or three years, again, unrelated necessarily to ACA and to healthcare reform, but just around the value proposition and how we sell and also how we get and generate leads from our partners in major accounts and in SBS. I think we've had great sales leadership there for several years and I think great general management leadership where these investments that they've made in the user experience and in technology without again changing the underlying platform. But I think the presentation of the experience to the employees and the clients has been enhanced significantly. And then there has been some good old-fashioned improvement, if you will, from a continuous improvement standpoint in just processes in terms how open enrollment is conducted, how new clients are implemented. So I think they've just had great execution, and I think they have some help now from the market in terms of healthcare reform.

<Q – Mark Marcon – Robert W. Baird & Co. Equity Capital Markets>: Great, thank you.

Operator: Thank you. We have time for one more question, and the next question is from Jeff Silber of BMO Capital Markets. Your line is open. Pardon me, Jeff. Your line is open.

<Q – Henry Chien – BMO Capital Markets (United States)>: Hi, sorry. I was on mute. This is actually Henry Chien calling on behalf of Jeff, just a quick one from me. About margin guidance for ES, I just want to double-check that nothing has changed. Does it continue to be driven by sales productivity and the migration of clients? Thanks.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: I'm sorry, can you repeat that again? The margin question on ES was?

<Q – Henry Chien – BMO Capital Markets (United States)>: In terms of your guidance for margin expansion in ES.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: No, I believe we included in the press release that our guidance is consistent with our prior guidance, if I'm not mistaken. So I'm just reading it through here...

<A – Elena Charles – Automatic Data Processing, Inc.>: I think you were thinking that it was due to the migrations in sales efficiencies. There are also a lot of operating efficiencies going on. I wouldn't attribute it to migrations at this point.

<A – Carlos Rodriguez – Automatic Data Processing, Inc.>: Again, to be clear, our guidance, I think what we stated in the press release, which was consistent from our guidance because this is our guidance for the entire year, is a pre-tax margin expansion of about 100 basis points. So that would include both the negative impact of migrations and sales costs but also positives of what Elena was referring to. We're obviously doing a lot of things to try to get more efficient and better at what we do.

<Q – Henry Chien – BMO Capital Markets (United States)>: Got it, thanks for the clarification.

Operator: Thank you. At this time, I'd like to turn the call back over to Carlos Rodriguez for closing remarks.

Carlos A. Rodriguez, President and Chief Executive Officer

Thanks very much for joining us today. As you can tell, we're very pleased with our results for the quarter. You can also tell that we're obviously still very committed to our shareholder-friendly actions around dividends and share buybacks notwithstanding the delay in buybacks as a result of waiting for the announcement for Dealer Services. Over the next couple of months we're obviously going to be working very diligently and there are a lot of people putting a lot of effort, a lot of hard work to getting the spinoff of Dealer Services completed, and we're going to update you along the way about our progress.

I hope you share my enthusiasm for Dealer's future as well as ADP's future, given that the transaction is going to free Dealer to focus on their own industry while obviously highlighting our commitment to being the global leader in Human Capital Management. I think that the transaction is going to position both companies for a great future and strong growth. Again, we thank you for joining us this quarter. We look forward to seeing you and talking to you next quarter. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day.