AUTOMATIC DATA PROCESSING INC
Form 10-Q
February 01, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2016

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From to

Commission File Number 1-5397

AUTOMATIC DATA PROCESSING, INC.
(Exact name of registrant as specified in its charter)

Delaware	22-1467904
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
One ADP Boulevard, Roseland, New Jersey	07068
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: (973) 974-5000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

The number of shares outstanding of the registrant’s common stock as of January 27, 2017 was 448,902,582.

Table of Contents

Part I. FINANCIAL INFORMATION
Item 1. Financial Statements
Automatic Data Processing, Inc. and Subsidiaries
Statements of Consolidated Earnings
(In millions, except per share amounts)
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
REVENUES:				
Revenues, other than interest on funds held for clients and PEO revenues	$2,077.4	$1,984.4	$4,114.8	$3,913.0
Interest on funds held for clients	91.8	89.3	181.0	177.1
PEO revenues (A)	818.1	733.3	1,608.4	1,430.9
TOTAL REVENUES	2,987.3	2,807.0	5,904.2	5,521.0
EXPENSES:				
Costs of revenues:				
Operating expenses	1,560.4	1,479.4	3,091.9	2,919.3
Systems development and programming costs	152.5	149.6	307.4	305.7
Depreciation and amortization	54.9	53.5	112.2	104.0
TOTAL COSTS OF REVENUES	1,767.8	1,682.5	3,511.5	3,329.0
Selling, general, and administrative expenses	640.8	627.2	1,288.6	1,232.4
Interest expense	20.5	16.8	40.4	21.8
TOTAL EXPENSES	2,429.1	2,326.5	4,840.5	4,583.2
Other income, net	(228.0)	(27.4)	(251.1)	(75.1)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	786.2	507.9	1,314.8	1,012.9
Provision for income taxes	275.3	166.5	435.2	334.0
NET EARNINGS FROM CONTINUING OPERATIONS	$510.9	$341.4	$879.6	$678.9
LOSS FROM DISCONTINUED OPERATIONS BEFORE INCOME TAXES	—	—	—	(1.4)
Benefit for income taxes	—	—	—	(0.5)
NET LOSS FROM DISCONTINUED OPERATIONS	$—	$—	$—	$(0.9)
NET EARNINGS	$510.9	$341.4	$879.6	$678.0
Basic Earnings Per Share from Continuing Operations	$1.14	$0.75	$1.95	$1.48
Basic Loss Per Share from Discontinued Operations	—	—	—	—
BASIC EARNINGS PER SHARE	$1.14	$0.75	$1.95	$1.47
Diluted Earnings Per Share from Continuing Operations	$1.13	$0.74	$1.94	$1.47
Diluted Loss Per Share from Discontinued Operations	—	—	—	—
DILUTED EARNINGS PER SHARE	$1.13	$0.74	$1.94	$1.46

Basic weighted average shares outstanding	447.9	457.6	450.1	460.0
Diluted weighted average shares outstanding	450.3	460.3	452.7	462.9
Dividends declared per common share	$0.570	$0.530	$1.100	$1.020

(A) Professional Employer Organization ("PEO") revenues are net of direct pass-through costs, primarily consisting of payroll wages and payroll taxes of $9,145.5 million and $8,373.0 million for the three months ended December 31, 2016 and 2015, respectively, and $16,833.1 million and $15,238.2 million for the six months ended December 31, 2016 and 2015, respectively.

See notes to the Consolidated Financial Statements.

3

Automatic Data Processing, Inc. and Subsidiaries
Statements of Consolidated Comprehensive Income
(In millions)
(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2015	2016	2015
Net earnings	$510.9	$341.4	$879.6	$678.0
Other comprehensive income/loss:				
Currency translation adjustments	(55.0)	(24.4)	(44.2)	(46.4)
Unrealized net losses on available-for-sale securities	(413.3)	(174.3)	(484.7)	(121.0)
Tax effect	145.4	62.5	171.6	42.6
Reclassification of net (gains)/losses on available-for-sale securities to net earnings	(1.3)	3.8	(1.4)	3.8
Tax effect	0.6	(1.2)	0.6	(1.2)
Reclassification of pension liability adjustment to net earnings	5.1	3.0	10.2	5.9
Tax effect	(1.8)	(1.1)	(3.7)	(2.2)
Other comprehensive loss, net of tax	(320.3)	(131.7)	(351.6)	(118.5)
Comprehensive income	$190.6	$209.7	$528.0	$559.5

See notes to the Consolidated Financial Statements.

Automatic Data Processing, Inc. and Subsidiaries
Consolidated Balance Sheets
(In millions, except per share amounts)
(Unaudited)

	December 31, 2016	June 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	$2,705.2	$3,191.1
Accounts receivable, net of allowance for doubtful accounts of $45.6 and $38.1, respectively	1,839.5	1,742.8
Other current assets	837.0	725.3
Total current assets before funds held for clients	5,381.7	5,659.2
Funds held for clients	30,426.4	33,841.2
Total current assets	35,808.1	39,500.4
Long-term receivables, net of allowance for doubtful accounts of $0.8 and $0.5, respectively	24.6	27.1
Property, plant and equipment, net	733.2	685.0
Other assets	1,228.2	1,241.3
Goodwill	1,652.9	1,682.0
Intangible assets, net	552.4	534.2
Total assets	$39,999.4	$43,670.0
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$137.4	$152.3
Accrued expenses and other current liabilities	1,420.3	1,246.8
Accrued payroll and payroll-related expenses	444.7	616.7
Dividends payable	253.2	238.4
Short-term deferred revenues	215.4	233.2
Income taxes payable	82.7	28.2
Total current liabilities before client funds obligations	2,553.7	2,515.6
Client funds obligations	30,402.6	33,331.8
Total current liabilities	32,956.3	35,847.4
Long-term debt	2,002.5	2,007.7
Other liabilities	770.6	701.1
Deferred income taxes	85.1	251.1
Long-term deferred revenues	369.8	381.1
Total liabilities	36,184.3	39,188.4
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, $1.00 par value: Authorized, 0.3 shares; issued, none	—	—
Common stock, $0.10 par value: authorized, 1,000.0 shares; issued, 638.7 shares at December 31, 2016 and June 30, 2016; outstanding, 448.9 and 455.7 shares at December 31, 2016 and June 30, 2016, respectively	63.9	63.9
Capital in excess of par value	784.2	768.1
Retained earnings	14,384.7	14,003.3
Treasury stock - at cost: 189.8 and 183.0 shares at December 31, 2016 and June 30, 2016, respectively	(10,851.0)	(10,138.6)

Accumulated other comprehensive loss	(566.7)	(215.1)
Total stockholders' equity	3,815.1	4,481.6
Total liabilities and stockholders' equity	$39,999.4	$43,670.0

See notes to the Consolidated Financial Statements.

5

Automatic Data Processing, Inc. and Subsidiaries
Statements of Consolidated Cash Flows
(In millions)
(Unaudited)

	Six Months Ended December 31,	
	2016	2015
Cash Flows from Operating Activities:		
Net earnings	$879.6	$678.0
Adjustments to reconcile net earnings to cash flows provided by operating activities:		
Depreciation and amortization	156.0	141.4
Deferred income taxes	27.7	36.7
Stock-based compensation expense	66.9	70.7
Net pension expense	12.1	8.8
Net amortization of premiums and accretion of discounts on available-for-sale securities	45.5	48.0
Gain on sale of building	—	(13.9)
Gain on sale of divested businesses, net of tax	(121.4)	(21.8)
Other	13.6	9.8
Changes in operating assets and liabilities, net of effects from acquisitions and divestitures of businesses:		
Increase in accounts receivable	(119.7)	(111.2)
Increase in other assets	(144.1)	(226.1)
Decrease in accounts payable	(16.1)	(18.0)
Increase / (Decrease) in accrued expenses and other liabilities	41.0	(87.0)
Net cash flows provided by operating activities	841.1	515.4
Cash Flows from Investing Activities:		
Purchases of corporate and client funds marketable securities	(2,359.5)	(2,439.5)
Proceeds from the sales and maturities of corporate and client funds marketable securities	1,878.0	2,664.2
Net decrease / (increase) in restricted cash and cash equivalents held to satisfy client funds obligations	3,213.0	(6,063.2)
Capital expenditures	(119.7)	(99.4)
Additions to intangibles	(106.6)	(105.7)
Acquisitions of businesses, net of cash acquired	(20.0)	—
Proceeds from the sale of property, plant, and equipment and other assets	—	15.7
Proceeds from the sale of divested businesses	234.0	162.2
Net cash flows provided by / (used in) investing activities	2,719.2	(5,865.7)
Cash Flows from Financing Activities:		
Net (decrease) / increase in client funds obligations	(2,799.9)	5,793.6
Net proceeds from debt issuance	—	1,986.3
Payments of debt	(1.0)	(1.2)
Repurchases of common stock	(765.3)	(773.0)
Net proceeds from stock purchase plan and stock-based compensation plans	19.2	3.3
Dividends paid	(482.3)	(458.8)
Other	—	(23.4)
Net cash flows (used in) / provided by financing activities	(4,029.3)	6,526.8
Effect of exchange rate changes on cash and cash equivalents	(16.9)	(20.9)

Net change in cash and cash equivalents	(485.9)	1,155.6
Cash and cash equivalents, beginning of period	3,191.1	1,639.3
Cash and cash equivalents, end of period	$2,705.2	$2,794.9
Supplemental disclosures of cash flow information:		
Cash paid for interest	$39.2	$4.3
Cash paid for income taxes, net of income tax refunds	$332.6	$311.9

See notes to the Consolidated Financial Statements.

6

Automatic Data Processing, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements
(Tabular dollars in millions, except per share amounts)
(Unaudited)
Note 1. Basis of Presentation

The accompanying Consolidated Financial Statements and footnotes thereto of Automatic Data Processing, Inc. and its subsidiaries (“ADP” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Consolidated Financial Statements and footnotes thereto are unaudited. In the opinion of the Company’s management, the Consolidated Financial Statements reflect all adjustments, which are of a normal recurring nature, that are necessary for a fair presentation of the Company’s interim financial results.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenue, expenses, and accumulated other comprehensive income that are reported in the Consolidated Financial Statements and footnotes thereto. Actual results may differ from those estimates. The Consolidated Financial Statements and all relevant footnotes have been adjusted for all businesses that qualify as a discontinued operation. The Interim Financial Data by Segment has been adjusted to reflect a change in the Company's segment profitability measure for all periods presented. Refer to Note 16 for further information.

Interim financial results are not necessarily indicative of financial results for a full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2016 (“fiscal 2016”).

Note 2. New Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In July 2016, the Company adopted Accounting Standards Update ("ASU") 2016-09, "Compensation - Stock Compensation - Improvements to Employee Share-Based Payment Accounting (Topic 718)." As a result of this standard, the Company prospectively recorded income tax benefits and deficiencies with respect to stock-based compensation as income tax expense or benefit in the income statement for periods beginning after July 1, 2016. This resulted in a $4.9 million and $20.3 million benefit in our income tax expense for the three and six months ended December 31, 2016, respectively. The Company retrospectively classified excess tax benefits as an operating activity on the Statements of Consolidated Cash Flows, which increased operating cash flows and decreased financing cash flows by $22.7 million for the six months ended December 31, 2015. Refer to Note 13 for the impact of the prospective adoption of the excess tax benefits in the income statement for the three and six months ended December 31, 2016.

In July 2016, the Company prospectively adopted ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement." The update provides guidance on whether a cloud computing arrangement includes a software license. For new and materially modified cloud computing arrangements that include a software license entered into after July 1, 2016, the Company accounted for the software license element consistent with the acquisition of other software licenses. If the new or materially modified cloud computing arrangement did not include a software license, the Company accounted for the arrangement as a service contract. The adoption of ASU 2015-05 did not have a material impact on the Company's consolidated results of operations, financial condition, or cash flows.

In July 2016, the Company prospectively adopted ASU 2015-04, "Compensation - Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets." The update allows an entity to remeasure their pension and other post-retirement benefit plan assets and liabilities at the month-end closest to a significant event such as a plan amendment, curtailment, or settlement. The adoption had no impact on the Company's consolidated results of operations, financial condition, or cash flows as presented, however the future impact of ASU 2015-04 will be dependent upon the nature of future significant events impacting the Company's pension plans, if any.

Recently Issued Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-01, "Business Combinations (Topic 805) - Clarifying the Definition of a Business" to clarify the definition of a business in order to allow for the evaluation of whether transactions should be accounted for as acquisitions or disposals of assets or businesses. ASU 2017-01 will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The future impact of ASU 2017-01 will be dependent upon the nature of future acquisitions or dispositions made by the Company, if any.

In February 2016, FASB issued ASU 2016-02, "Leases (Topic 842)." This update amends the existing accounting standards for lease accounting, and requires lessees to recognize most lease assets and lease liabilities on the balance sheet and to disclose key information about leasing arrangements. ASU 2016-02 requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application. ASU 2016-02 will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company has not yet determined the impact of ASU 2016-02 on its consolidated results of operations, financial condition, or cash flows.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and has since issued additional amendments to ASU 2014-09. These new standards require an entity to recognize revenue depicting the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standards will also result in enhanced revenue related disclosures. Entities have the option to apply the new guidance under a retrospective approach to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Statements of Consolidated Financial Position. The new standards are effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2017. Early adoption is permitted. The Company expects to adopt the new standard in its fiscal year beginning on July 1, 2018 and anticipates applying the guidance under the full retrospective approach. The Company has not fully determined the impact of these new revenue recognition standards on its consolidated results of operations, financial condition, or cash flows; however, the Company expects the provisions to primarily impact the manner in which it treats certain costs to fulfill contracts (i.e., implementation costs) and costs to acquire new contracts (i.e., selling costs). Generally, as it relates to these two items, the provisions of the new standard will result in the Company deferring additional costs on the Consolidated Balance Sheets and subsequently amortizing them to the Statements of Consolidated Earnings over the expected client life.

Note 3. Acquisitions

In January 2017, the Company acquired The Marcus Buckingham Company, Inc. ("TMBC") for total cash consideration at closing of approximately $70.0 million and contingent consideration of up to $35.0 million, which is payable over the next three years, subject to the achievement of specified financial metrics and/or other conditions. TMBC is a provider of talent management technology, coaching and consulting solutions. The results of TMBC will be reported within the Company’s Employer Services segment. The Company has not yet finalized the purchase price allocation or its valuation of the contingent consideration arrangement for this acquisition.

The Company acquired one business during the six months ended December 31, 2016 for $20.0 million, net of cash acquired. The acquisition was not material to the Company's results of operations, financial position, or cash flows and, therefore, the pro forma impact of this acquisition is not presented.

Assets acquired and liabilities assumed in the business combination were recorded on the Company’s Consolidated Balance Sheets as of the acquisition date based upon the estimated fair value at such date. The results of operations of the business acquired by the Company have been included in the Statements of Consolidated Earnings since the date of acquisition. The excess of the purchase price over the estimated fair value of the underlying assets acquired and liabilities assumed was allocated to goodwill. The allocation of the excess purchase price was based upon preliminary estimates and assumptions and is subject to revision when the Company receives final information. Accordingly, the measurement period for such purchase price allocations will end when the information, or the facts and circumstances, becomes available, but will not exceed twelve months.

Note 4. Divestitures

On November 28, 2016, the Company completed the sale of its Consumer Health Spending Account ("CHSA") and Consolidated Omnibus Reconciliation Act ("COBRA") businesses for a pre-tax gain of $205.4 million, and recorded such gain within Other income, net on the Statements of Consolidated Earnings. The historical results of operations of these businesses are included in the Employer Services segment.

On September 1, 2015, the Company completed the sale of its AdvancedMD ("AMD") business for a pre-tax gain of $29.1 million, and recorded such gain within Other income, net on the Statements of Consolidated Earnings. The historical results of operations of this business is included in the Other segment.

The Company determined that the CHSA, COBRA and AMD divestitures did not meet the criteria for reporting discontinued operations under ASU 2014-08 as the disposition of these businesses does not represent a strategic shift that has a major effect on the Company's operations or financial results.

Note 5. Service Alignment Initiative

On July 28, 2016, the Company announced a Service Alignment Initiative that is intended to simplify the Company's service organization by aligning the Company's service operations to its strategic platforms and locations. In fiscal 2016, the Company entered into leases in Norfolk, Virginia and Maitland, Florida, and in October 2016, the Company entered into a lease in Tempe, Arizona as part of this effort. The Company began incurring charges for this initiative during the first quarter of the fiscal year and expects to continue to incur charges throughout the year ended June 30, 2017 ("fiscal 2017") and the year ended June 30, 2018 ("fiscal 2018") as the initiative is executed. The charges primarily relate to employee separation benefits recognized under Accounting Standards Codification ("ASC") 712, and also include charges for the relocation of certain current Company employees, lease termination costs, and accelerated depreciation of fixed assets. The Company expects to recognize pre-tax restructuring charges in the range of $100 million to $125 million through fiscal 2018, consisting primarily of cash expenditures for employee separation benefits in the range of $75 million to $85 million, and other initiative costs in the range of $25 million to $40 million.