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ADP Delivers an Impressive Quarter

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Automatic Data Processing (ADP) delivered a very impressive quarter with both EPS and revenue exceeding analysts' expectations. From the guidance provided by the company and applying the historical P/E rate to the stock, ADP should garner a valuation of $51 to $54 in the next year. Management did fire some warning shots, however, when it dropped interest revenue guidance and assumptions, so we cannot fully discount this headwind. As a result, the lower end of the forecast may be more reasonable than the upper end.

ADP reported first-quarter 2008 EPS of 45 cents. Excluding last year's one-time gain, EPS from continuing operations rose 25%. Net revenue rose 13.5% year over year, to $1.992 billion. Acquisitions are expected to add $20 million in revenues in 2008.

Pretax margins rose 110 basis points, and average interest yield rose 30 basis points, to 4.6%.

The cash balance dropped from $1.9 billion at the end of June to $1.5 billion. Accounting for a most of this decline was the repurchase of 11 million shares in the quarter for about $514 million, bringing the total repurchase to nearly 12 million shares for about $560 million since the beginning of 2007. Share buybacks would equate to a penny of EPS accretion for the year.

Employer Services saw 11% revenue growth, 9% organic growth and 8% growth in payroll and tax filing services. Professional Employer Organization Services posted strong results, with 21% revenue growth and a 250-basis-point increase in pre-tax margins. Dealer Services revenue grew 8%.

ADP raised its fiscal 2008 revenue growth forecast to 12% to 13% based on the weak dollar and acquisitions. Management lowered the anticipated growth in client funds interest, however, to an increase of 8% from the original 13% to 14%, which equates to a haircut of $30 million to $40 million based on **FOMC** cuts and anticipated cuts derived from futures contracts and forward yield curve. The average yield on client funds will be nearly 4.5% vs. the original forecast of 4.7% and 5.5% in 2007. Client funds balances will grow about 7% to 8% vs. the original forecast of 8%. The company expects EPS growth of 18% to 21% from the 2007 EPS of $1.80, excluding one-time gains. No additional stock repurchases are contemplated beyond that of historical activity.

ADP Preview: Experiencing Some Headwinds

Automatic Data Processing (ADP) is scheduled to release its first-quarter 2008 results and conduct its quarterly conference call before the market opens on

Tuesday. ADP is expected to earn 43 cents on revenue of $1.97 billion. In the year-ago quarter, ADP earned 43 cents on revenue of $2.22 billion. In the sequential quarter (fourth quarter 2007 for ADP), the company earned 36 cents.

Recently, ADP has gained notoriety for its monthly report on employment, which is viewed by many traders and media outlets as a forecaster of the monthly jobs report that is issued by the U.S. Department of Labor Statistics. Unfortunately for ADP, the track record of its report is less than stellar.

Nevertheless, ADP has been trying to add customers and hence payroll processing counts by aggressively buying up smaller processing companies in this highly competitive business. **Intuit** (INTU) and **Paychex** (PAYX) are some of ADP's chief competitors. I have a good friend and client who operates a small independent payroll processing business. He is constantly receiving overtures from those payroll processing giants.

Beside the intense competition, ADP may be experiencing some headwinds. First is the slowing growth in payrolls. While employment growth remains positive, the rate of growth has declined over the last year. Second are declining interest rates. ADP makes a considerable amount of money on the float, which is due to the timing between the employer payment of payrolls to ADP and the clearing of the individual employee checks. Furthermore, with more people opting for direct debit, ADP's float base is also declining.

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At the time of publication, Rothbort had no positions in the stocks mentioned, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

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