

AUTOMATIC DATA PROCESSING INC
Form 10-Q
November 05, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2015

OR

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

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 No

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.

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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 y

The number of shares outstanding of the registrant's common stock as of October 31, 2015 was 461,206,624.

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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 September 30,	
	2015	2014
REVENUES:		
Revenues, other than interest on funds held for clients and PEO revenues	\$1,928.7	\$1,884.4
Interest on funds held for clients	87.8	90.2
PEO revenues (A)	697.5	591.5
TOTAL REVENUES	2,714.0	2,566.1
EXPENSES:		
Costs of revenues:		
Operating expenses	1,439.8	1,361.2
Systems development and programming costs	156.1	145.6
Depreciation and amortization	50.6	51.5
TOTAL COSTS OF REVENUES	1,646.5	1,558.3
Selling, general, and administrative expenses	605.3	576.0
Interest expense	4.9	1.9
TOTAL EXPENSES	2,256.7	2,136.2
Other income, net	(47.7) (20.5
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	505.0	450.4
Provision for income taxes	167.5	153.8
NET EARNINGS FROM CONTINUING OPERATIONS	\$337.5	\$296.6
(LOSS)/EARNINGS FROM DISCONTINUED OPERATIONS BEFORE INCOME TAXES	(1.4) 67.7
(Benefit)/Provision for income taxes	(0.5) 69.1
NET LOSS FROM DISCONTINUED OPERATIONS	\$(0.9) \$(1.4
NET EARNINGS	\$336.6	\$295.2
Basic Earnings Per Share from Continuing Operations	\$0.73	\$0.62
Basic Loss Per Share from Discontinued Operations	—	—
BASIC EARNINGS PER SHARE	\$0.73	\$0.62
Diluted Earnings Per Share from Continuing Operations	\$0.72	\$0.62
Diluted Loss Per Share from Discontinued Operations	—	—
DILUTED EARNINGS PER SHARE	\$0.72	\$0.61
Basic weighted average shares outstanding	462.4	478.4

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Diluted weighted average shares outstanding	465.7	481.7
Dividends declared per common share	\$0.490	\$0.480

(A) Professional Employer Organization (“PEO”) revenues are net of direct pass-through costs, primarily consisting of payroll wages and payroll taxes, of \$6,865.3 million and \$5,736.2 million for the three months ended September 30, 2015 and 2014, respectively.

See notes to the Consolidated Financial Statements.

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

	Three Months Ended September 30,	
	2015	2014
Net earnings	\$336.6	\$295.2
Other comprehensive income/(loss):		
Currency translation adjustments	(22.0)	(108.9)
Unrealized net gains/(losses) on available-for-sale securities	53.4	(94.1)
Tax effect	(20.0)	34.0
Reclassification of net gains on available-for-sale securities to net earnings	—	(0.8)
Tax effect	—	0.3
Reclassification of pension liability adjustment to net earnings	2.9	8.2
Tax effect	(1.1)	(2.8)
Other comprehensive income/(loss), net of tax	13.2	(164.1)
Comprehensive income	\$349.8	\$131.1

See notes to the Consolidated Financial Statements.

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

	September 30, 2015	June 30, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$3,184.7	\$1,639.3
Short-term marketable securities	27.2	26.6
Accounts receivable, net	1,565.2	1,546.9
Other current assets	890.3	731.1
Total current assets before funds held for clients	5,667.4	3,943.9
Funds held for clients	24,508.7	24,865.3
Total current assets	30,176.1	28,809.2
Long-term marketable securities	21.3	28.9
Long-term receivables, net	32.6	32.2
Property, plant and equipment, net	680.3	672.7
Other assets	1,309.2	1,270.8
Goodwill	1,684.6	1,793.5
Intangible assets, net	476.2	503.2
Total assets	\$34,380.3	\$33,110.5
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$146.5	\$194.5
Accrued expenses and other current liabilities	1,252.2	1,159.2
Accrued payroll and payroll-related expenses	405.6	627.3
Dividends payable	225.7	226.4
Short-term deferred revenues	218.1	228.6
Income taxes payable	99.0	27.2
Total current liabilities before client funds obligations	2,347.1	2,463.2
Client funds obligations	24,240.2	24,650.5
Total current liabilities	26,587.3	27,113.7
Long-term debt	1,995.2	9.2
Other liabilities	648.0	644.3
Deferred income taxes	162.9	172.1
Long-term deferred revenues	356.7	362.7
Total liabilities	\$29,750.1	\$28,302.0
Commitments and contingencies (Note 13)		
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 September 30, 2015 and June 30, 2015; outstanding, 463.4 and 466.4 shares at September 30, 2015 and June 30, 2015, respectively	63.9	63.9
Capital in excess of par value	659.6	663.3
Retained earnings	13,568.6	13,460.3

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Treasury stock - at cost: 175.3 and 172.3 shares at September 30, 2015 and June 30, 2015, respectively	(9,414.5)	(9,118.4)
Accumulated other comprehensive loss	(247.4)	(260.6)
Total stockholders' equity	4,630.2	4,808.5
Total liabilities and stockholders' equity	\$34,380.3	\$33,110.5

See notes to the Consolidated Financial Statements.

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

	Three Months Ended September 30,	
	2015	2014
Cash Flows from Operating Activities:		
Net earnings	\$336.6	\$295.2
Adjustments to reconcile net earnings to cash flows provided by operating activities:		
Depreciation and amortization	68.8	67.7
Deferred income taxes	29.4	9.3
Stock-based compensation expense	34.7	38.7
Excess tax benefit related to exercise of stock options and restricted stock	(15.9)	(44.2)
Net pension expense	4.4	5.8
Net amortization of premiums and accretion of discounts on available-for-sale securities	24.1	25.3
Gain on sale of divested businesses, net of tax	(21.8)	—
Other	5.8	(6.9)
Changes in operating assets and liabilities, net of effects from acquisitions and divestitures of businesses:		
(Increase) / decrease in accounts receivable	(32.3)	27.8
Increase in other assets	(249.2)	(224.4)
Decrease in accounts payable	(19.5)	(9.1)
Decrease in accrued expenses and other liabilities	(71.9)	(12.4)
Proceeds from the sale of notes receivable	—	207.2
Operating activities of discontinued operations	—	(1.8)
Net cash flows provided by operating activities	93.2	378.2
Cash Flows from Investing Activities:		
Purchases of corporate and client funds marketable securities	(859.8)	(894.2)
Proceeds from the sales and maturities of corporate and client funds marketable securities	1,255.3	595.2
Net (increase) / decrease in restricted cash and cash equivalents held to satisfy client funds obligations	(137.8)	1.5
Capital expenditures	(55.6)	(36.1)
Additions to intangibles	(45.4)	(43.9)
Acquisitions of businesses, net of cash acquired	—	(8.1)
Proceeds from the sale of property, plant, and equipment and other assets	—	23.6
Dividend received from CDK Global, Inc.	—	825.0
Cash retained by CDK Global, Inc.	—	(180.0)
Proceeds from the sale of divested businesses	162.5	—
Investing activities of discontinued operations	—	(15.9)
Net cash flows provided by investing activities	319.2	267.1
Cash Flows from Financing Activities:		
Net (decrease) / increase in client funds obligations	(275.1)	47.3
Net proceeds from debt issuance	1,986.4	—
Payments of debt	(0.6)	(0.6)
Repurchases of common stock	(308.1)	(61.2)
Net proceeds from stock purchase plan and stock-based compensation plans	(22.0)	16.5

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Excess tax benefit related to exercise of stock options and restricted stock	15.9	44.2	
Dividends paid	(229.0)	(229.8))
Net repayments of commercial paper borrowings	—	(236.0))
Other	(23.4)	—)
Financing activities of discontinued operations	—	1.6	
Net cash flows provided by / (used in) financing activities	1,144.1	(418.0))
Effect of exchange rate changes on cash and cash equivalents	(11.1)	(35.2))
Net change in cash and cash equivalents	1,545.4	192.1	
Cash and cash equivalents, beginning of period	1,639.3	1,983.6	
Cash and cash equivalents, end of period	3,184.7	2,175.7	
Less cash and cash equivalents of discontinued operations, end of period	—	2.2	
Cash and cash equivalents of continuing operations, end of period	\$3,184.7	\$2,173.5	
See notes to the Consolidated Financial Statements.			

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, costs, 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 (see Note 3). The Interim Financial Data by Segment has also been adjusted to reflect the historical results of the AdvancedMD ("AMD") business within the Other segment (see Note 15).

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, 2015 ("fiscal 2015").

Note 2. New Accounting Pronouncements

In July 2015, the Company adopted Accounting Standards Update ("ASU") 2015-03, "Simplifying the Presentation of Debt Issuance Costs." Debt issuance costs have been presented on the consolidated balance sheets as a direct deduction from the carrying amount of the related debt liability. ASU 2015-03 did not have a material impact on the Company's consolidated results of operations, financial condition, or cash flows.

In July 2015, the Company adopted ASU 2014-08, "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 requires that a disposal representing a strategic shift that has (or will have) a major effect on an entity's financial results or a business activity classified as held for sale should be reported as a discontinued operation. As a result of ASU 2014-08, the Company did not classify AMD as a discontinued operation. The businesses classified as a discontinued operation prior to June 30, 2015 continue to be classified as a discontinued operation (see Note 3).

In September 2015, the Company adopted ASU 2015-16, "Simplifying the Accounting for Measurement Period Adjustments." The update eliminates the need to retrospectively adjust prior period information in the financial statement for acquisition adjustments to goodwill during the measurement period. The impact of ASU 2015-16 will be dependent on any future acquisitions, if any.

In April 2015, the Financial Accounting Standards Board ("FASB") issued 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. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 is effective for fiscal years, and interim periods within those

fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company has not yet determined the impact of ASU 2015-05 on its consolidated results of operations, financial condition, or cash flows.

In April 2015, the FASB issued 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. ASU 2015-04 is effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2015. Early adoption is permitted. The impact of ASU 2015-04 is dependent upon the nature of future significant events impacting the Company's pension plans, if any.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," 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. ASU 2014-09 requires 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. ASU 2014-09 will also result in enhanced revenue related disclosures. ASU 2014-09 is effective for fiscal years, and interim reporting periods within those years, beginning after December 15, 2017. Early adoption is permitted. The Company has not yet determined the impact of ASU 2014-09 on its consolidated results of operations, financial condition, or cash flows.

Note 3. Divestitures

A. Disposition

On September 1, 2015, the Company completed the sale of its AMD business for a pre-tax gain of \$29.1 million, less costs to sell, and recorded such gain within Other income, net on the Statements of Consolidated Earnings. The Company determined that the disposition did not meet the criteria for reporting discontinued operations under ASU 2014-08, which was adopted prospectively on July 1, 2015, as the disposition of this business does not represent a strategic shift that has a major effect on the Company's operations or financial results. Beginning in the first quarter of the fiscal year ending June 30, 2016 ("fiscal 2016"), the historical results of AMD are being reported in the Other segment (see Note 15).

B. Discontinued Operations

On June 26, 2015, the Company completed the sale of its Procure-to-Pay business ("P2P"), which was previously reported in the Employer Services segment, for a pre-tax gain of \$100.9 million, less costs to sell, and recorded such gain within earnings from discontinued operations on the Statements of Consolidated Earnings.

On September 30, 2014, the Company completed the tax free spin-off of its former Dealer Services business, which was a separate reportable segment, into an independent publicly traded company called CDK Global, Inc. ("CDK"). As a result of the spin-off, ADP stockholders of record on September 24, 2014 (the "record date") received one share of CDK common stock on September 30, 2014, par value \$0.01 per share, for every three shares of ADP common stock held by them on the record date and cash for any fractional shares of CDK common stock. ADP distributed approximately 160.6 million shares of CDK common stock in the distribution. During the three months ended September 30, 2015, the Company became aware that 1.0 million of the 160.6 million shares of CDK stock distributed at the distribution date were inadvertently issued and distributed with respect to certain unvested Company equity awards. The 1.0 million shares were canceled during the three months ended September 30, 2015. Such shares distributed as part of the spin-off did not have any impact to previously reported results of operations, financial condition, or cash flows. The spin-off was made without the payment of any consideration or the exchange of any shares by ADP stockholders. The spin-off, transitional, and on-going relationships between ADP and CDK are governed by the Separation and Distribution Agreement entered into between ADP and CDK and certain other ancillary agreements.

Incremental costs associated with the spin-off of CDK of \$42.8 million for the three months ended September 30, 2014 are included in discontinued operations on the Statements of Consolidated Earnings.

In conjunction with the spin-off of CDK and the sale of P2P, the Company has classified the operating results of these businesses as discontinued operations for all periods presented. Results for discontinued operations were as follows:

	Three Months Ended September 30,	
	2015	2014
Revenues	\$—	\$516.6
Earnings from discontinued operations before income taxes	—	67.7
Provision for income taxes	—	69.1
Net loss from discontinued operations before gain on disposal of discontinued operations	—	(1.4)
Adjustment of gain on disposal of P2P	(1.4)	—
Provision for income taxes	(0.5)	—
Net adjustment of gain on disposal of P2P	(0.9)	—
Net loss from discontinued operations	\$(0.9)	\$(1.4)

Note 4. Earnings per Share (“EPS”)

	Basic	Effect of Employee Stock Option Shares	Effect of Employee Restricted Stock Shares	Diluted
Three Months Ended September 30, 2015				
Net earnings from continuing operations	\$337.5			\$337.5
Weighted average shares (in millions)	462.4	1.3	2.0	465.7
EPS from continuing operations	\$0.73			\$0.72
Three Months Ended September 30, 2014				
Net earnings from continuing operations	\$296.6			\$296.6
Weighted average shares (in millions)	478.4	2.2	1.1	481.7
EPS from continuing operations	\$0.62			\$0.62

Options to purchase 1.3 million and 1.4 million shares of common stock for the three months ended September 30, 2015 and 2014, respectively, were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

Note 5. Other Income, Net

	Three Months Ended September 30,	
	2015	2014
Interest income on corporate funds	\$(18.6)	\$(18.3)
Realized gains on available-for-sale securities	(0.9)	(1.0)
Realized losses on available-for-sale securities	0.9	0.2
Gain on the sale of notes receivable (see Note 7)	—	(1.4)
Gain on sale of AMD (see Note 3)	(29.1)	—
Other income, net	\$(47.7)	\$(20.5)

Note 6. Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients at September 30, 2015 and June 30, 2015 were as follows:

	September 30, 2015			Fair Value (A)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
Type of issue:				
Money market securities, cash and other cash equivalents	\$7,367.1	\$—	\$—	\$7,367.1
Available-for-sale securities:				
Corporate bonds	9,250.8	125.7	(22.1) 9,354.4
U.S. Treasury and direct obligations of U.S. government agencies	5,300.6			