

AUTOMATIC DATA PROCESSING INC
Form 10-Q
January 31, 2019
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 December 31, 2018

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 22-1467904
(State or other jurisdiction of incorporation or (IRS Employer Identification No.)
organization)
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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes

No

The number of shares outstanding of the registrant's common stock as of January 25, 2019 was 435,629,656.

Table of Contents

	Page
<u>PART I – FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u>
	Statements of Consolidated Earnings Three and six months ended December 31, 2018 and 2017
	3
	Statements of Consolidated Comprehensive Income Three and six months ended December 31, 2018 and 2017
	4
	Consolidated Balance Sheets At December 31, 2018 and June 30, 2018
	5
	Statements of Consolidated Cash Flows Six months ended December 31, 2018 and 2017
	6
	<u>Notes to the Consolidated Financial Statements</u>
	7
<u>Item 2.</u>	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>
	29
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	43
<u>Item 4.</u>	<u>Controls and Procedures</u>
	43
<u>PART II – OTHER INFORMATION</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>
	43
<u>Item 1A.</u>	<u>Risk Factors</u>
	43
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	44
<u>Item 6.</u>	<u>Exhibits</u>
	45
	<u>Signatures</u>
	46

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		Six Months Ended	
	December 31,		December 31,	
	2017	2017	2017	2017
	2018	*As	2018	*As
		Restated		Restated
REVENUES:				
Revenues, other than interest on funds held for clients and PEO revenues	\$2,319.8	\$2,190.3	\$4,537.8	\$4,269.2
Interest on funds held for clients	129.1	106.7	247.6	206.1
PEO revenues (A)	1,057.0	941.3	2,043.7	1,840.2
TOTAL REVENUES	3,505.9	3,238.3	6,829.1	6,315.5
EXPENSES:				
Costs of revenues:				
Operating expenses	1,785.9	1,709.2	3,495.9	3,339.9
Systems development and programming costs	156.1	159.4	314.1	317.6
Depreciation and amortization	71.7	69.3	144.3	131.9
TOTAL COSTS OF REVENUES	2,013.7	1,937.9	3,954.3	3,789.4
Selling, general, and administrative expenses	745.2	723.6	1,459.0	1,399.0
Interest expense	38.6	27.5	74.5	55.5
TOTAL EXPENSES	2,797.5	2,689.0	5,487.8	5,243.9
Other income, net	(32.6)	(38.2)	(46.5)	(80.8)
EARNINGS BEFORE INCOME TAXES	741.0	587.5	1,387.8	1,152.4
Provision / (benefit) for income taxes	182.8	(82.9)	324.2	69.4
NET EARNINGS	\$558.2	\$670.4	\$1,063.6	\$1,083.0
BASIC EARNINGS PER SHARE	\$1.28	\$1.52	\$2.44	\$2.45
DILUTED EARNINGS PER SHARE	\$1.27	\$1.51	\$2.42	\$2.44
Basic weighted average shares outstanding	435.7	441.3	436.2	441.8
Diluted weighted average shares outstanding	438.0	443.7	438.9	444.4

*See Note 2 for a summary of adjustments.

(A) Professional Employer Organization (“PEO”) revenues are net of direct pass-through costs, primarily consisting of payroll wages and payroll taxes of \$11,751.1 million and \$10,632.3 million for the three months ended December 31, 2018 and 2017, respectively, and \$21,380.5 million and \$19,370.8 million for the six months ended December 31, 2018 and 2017, 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, 2017		Six Months Ended December 31, 2017	
	2018	*As Restated	2018	*As Restated
Net earnings	\$558.2	\$ 670.4	\$1,063.6	\$1,083.0
Other comprehensive income/loss:				
Currency translation adjustments	(24.7)	2.2	(47.6)	55.0
Unrealized net gains/(losses) on available-for-sale securities	168.3	(147.3)	118.0	(160.2)
Tax effect	(38.8)	53.1	(26.6)	56.6
Reclassification of net losses on available-for-sale securities to net earnings	0.5	1.0	1.4	1.1
Tax effect	(0.1)	(0.4)	(0.3)	(0.4)
Reclassification of pension liability adjustment to net earnings	26.2	2.3	26.3	4.6
Tax effect	(6.3)	(0.8)	(6.4)	(1.7)
Other comprehensive income/(loss), net of tax	125.1	(89.9)	64.8	(45.0)
Comprehensive income	\$683.3	\$ 580.5	\$1,128.4	\$1,038.0

*See Note 2 for a summary of adjustments.

See notes to the Consolidated Financial Statements.

4

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

	December 31, 2018	June 30, 2018 *As Restated
Assets		
Current assets:		
Cash and cash equivalents (A)	\$2,785.6	\$2,170.0
Accounts receivable, net of allowance for doubtful accounts of \$51.2 and \$51.3, respectively	2,638.1	1,984.2
Other current assets	653.0	531.3
Total current assets before funds held for clients	6,076.7	4,685.5
Funds held for clients	25,605.9	27,137.8
Total current assets	31,682.6	31,823.3
Long-term receivables, net of allowance for doubtful accounts of \$0.5 and \$0.5, respectively	25.2	25.5
Property, plant and equipment, net	772.7	793.7
Deferred contract costs	2,338.0	2,377.4
Other assets	739.7	699.3
Goodwill	2,321.4	2,243.5
Intangible assets, net	926.7	886.4
Total assets	\$38,806.3	\$38,849.1
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$151.3	\$135.4
Accrued expenses and other current liabilities	2,057.8	1,547.6
Accrued payroll and payroll-related expenses	445.1	667.7
Dividends payable	341.0	298.9
Short-term deferred revenues	224.0	225.7
Obligation under commercial paper borrowing (A)	1,206.0	—
Income taxes payable	29.4	43.9
Total current liabilities before client funds obligations	4,454.6	2,919.2
Client funds obligations	25,842.3	27,493.5
Total current liabilities	30,296.9	30,412.7
Long-term debt	2,002.3	2,002.4
Other liabilities	752.5	728.0
Deferred income taxes	580.5	522.0
Long-term deferred revenues	410.2	448.1
Total liabilities	34,042.4	34,113.2
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, 2018 and June 30, 2018; outstanding, 436.2 and 438.8 shares at December 31, 2018 and June 30, 2018, respectively	63.9	63.9

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Capital in excess of par value	1,076.1	1,014.8
Retained earnings	16,959.1	16,546.6
Treasury stock - at cost: 202.5 and 199.9 shares at December 31, 2018 and June 30, 2018, respectively	(12,720.2)	(12,209.6)
Accumulated other comprehensive loss	(615.0)	(679.8)
Total stockholders' equity	4,763.9	4,735.9
Total liabilities and stockholders' equity	\$38,806.3	\$38,849.1

*See Note 2 for a summary of adjustments.

(A) As of December 31, 2018, \$1,206.0 million of cash and cash equivalents are related to the Company's outstanding commercial paper borrowings (see Note 10).

See notes to the Consolidated Financial Statements.

5

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

	Six Months Ended December 31,	
	2018	2017 *As Restated
Cash Flows from Operating Activities:		
Net earnings	\$1,063.6	\$1,083.0
Adjustments to reconcile net earnings to cash flows provided by operating activities:		
Depreciation and amortization	196.5	182.0
Amortization of deferred contract costs	434.6	412.3
Deferred income taxes	33.0	(162.8)
Stock-based compensation expense	77.0	77.7
Net pension expense	31.5	5.5
Net amortization of premiums and accretion of discounts on available-for-sale securities	27.4	37.9
Impairment of intangible assets	12.1	—
Other	14.0	14.8
Changes in operating assets and liabilities, net of effects from acquisitions:		
Increase in accounts receivable	(670.0)	(337.1)
Increase in other assets	(594.4)	(667.6)
Increase / (decrease) in accounts payable	19.0	(2.7)
Increase in accrued expenses and other liabilities	287.2	32.1
Net cash flows provided by operating activities	931.5	675.1
Cash Flows from Investing Activities:		
Purchases of corporate and client funds marketable securities	(1,300.8)	(2,454.2)
Proceeds from the sales and maturities of corporate and client funds marketable securities	1,163.4	1,866.0
Capital expenditures	(80.0)	(118.3)
Additions to intangibles	(139.3)	(132.4)
Acquisitions of businesses, net of cash acquired	(120.4)	(487.4)
Proceeds from the sale of property, plant, and equipment	7.9	—
Net cash flows used in investing activities	(469.2)	(1,326.3)
Cash Flows from Financing Activities:		
Net (decrease) / increase in client funds obligations	(1,567.1)	7,207.1
Payments of debt	(1.1)	(6.3)
Repurchases of common stock	(526.6)	(408.3)
Net proceeds from stock purchase plan and stock-based compensation plans	5.5	(5.5)
Dividends paid	(605.0)	(506.7)
Net proceeds from commercial paper borrowings	1,206.0	—
Net cash flows (used in) / provided by financing activities	(1,488.3)	6,280.3
Effect of exchange rate changes on cash, cash equivalents, restricted cash, and restricted cash equivalents	(32.1)	49.1

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Net change in cash, cash equivalents, restricted cash, and restricted cash equivalents	(1,058.1)	5,678.2
Cash, cash equivalents, restricted cash, and restricted cash equivalents, beginning of period	6,542.1	8,181.6
Cash, cash equivalents, restricted cash, and restricted cash equivalents, end of period	\$5,484.0	\$13,859.8
Reconciliation of cash, cash equivalents, restricted cash, and restricted cash equivalents to the Consolidated Balance Sheets		
Cash and cash equivalents	\$2,785.6	\$1,773.4
Restricted cash and restricted cash equivalents included in funds held for clients (A)	2,698.4	12,086.4
Total cash, cash equivalents, restricted cash, and restricted cash equivalents	\$5,484.0	\$13,859.8
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$73.3	\$54.3
Cash paid for income taxes, net of income tax refunds	\$280.3	\$389.2

*See Note 2 for a summary of adjustments.

(A) See Note 8 for a reconciliation of restricted cash and restricted cash equivalents in funds held for clients on the Consolidated Balance Sheets.

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., its subsidiaries and variable interest entity (“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 Company has a grantor trust, which holds the majority of the funds provided by its clients pending remittance to employees of those clients, tax authorities, and other payees. The Company is the sole beneficial owner of the trust. The trust meets the criteria in Accounting Standards Codification (“ASC”) 810, “Consolidation” to be characterized as a variable interest entity (“VIE”). The Company has determined that it has a controlling financial interest in the trust because it has both (1) the power to direct the activities that most significantly impact the economic performance of the trust (including the power to make all investment decisions for the trust) and (2) the right to receive benefits that could potentially be significant to the trust (in the form of investment returns) and, therefore, consolidates the trust. Further information on these funds and the Company’s obligations to remit to its clients’ employees, tax authorities, and other payees is provided in Note 8, “Corporate Investments and Funds Held for Clients.”

Restatements

Effective July 1, 2018, certain prior period amounts have been restated to conform to the current period presentation in connection with the adoption of Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (ASC 606)” and ASU 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost.” Also, in the first quarter of the fiscal year ended June 30, 2019 (“fiscal 2019”), the Company’s chief operating decision maker (“CODM”) began reviewing segment results reported at actual interest rates and the results of the PEO segment inclusive of the results of ADP Indemnity. Additionally, the CODM reviews results with changes to certain corporate allocations. Refer to Note 2 and Note 17 for additional information.

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. 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, 2018 (“fiscal 2018”).

Note 2. New Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Effective July 1, 2018, the Company adopted ASU 2014-09, “Revenue from Contracts with Customers (ASC 606)” on a retrospective basis. 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 resulted in enhanced revenue-related disclosures. The standard primarily impacted 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). The provisions of the new standard require the Company to capitalize and amortize additional implementation costs than those capitalized and amortized under previous U.S. GAAP. Under previous U.S. GAAP, the Company immediately expensed all selling expenses. The adoption of the provisions of the new standard did not materially impact the timing or amount of revenue the Company recognized and did not result in significant changes in its business processes or systems. Refer to Note 3 for further details. Refer to the table below for a summary of the restatements required, as a result of this change, on the Company's statements of consolidated earnings for the three and six months ended December 31, 2017, consolidated balance sheets as of June 30, 2018, and consolidated cash flows for the six months ended December 31, 2017.

Effective July 1, 2018, the Company adopted ASU 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost." ASU 2017-07 requires reporting the service cost component in the same line item or items as other compensation costs arising during the period in the Statements of

Consolidated Earnings. The other components of net periodic pension cost are required to be presented in the Statements of Consolidated Earnings separately from the service cost component. The Company retrospectively adopted the new standard, and as a result reclassified the non-service cost components of the net periodic benefit cost from within the respective line items of our Statements of Consolidated Earnings to Other income, net. Refer to the table below for a summary of the reclassification required, as a result of this change, on the Company's consolidated results of operations for the three and six months ended December 31, 2017. The adoption of the new accounting rules only impacted the classification of expenses on the Statements of Consolidated Earnings and did not impact the Company's consolidated earnings, balance sheets, or cash flows.

Adoption of ASC 606 and ASU 2017-07 impacted the Company's prior period Statements of Consolidated Earnings, Consolidated Balance Sheets, and Consolidated Cash Flows as follows:

Statements of Consolidated Earnings

	Three Months Ended December 31, 2017			As restated
	As reported	Adjustments ASC 606	Adjustments ASU 2017-07	
Revenues, other than interest on funds held for clients and PEO revenues	\$2,188.8	\$ 1.5	\$	—\$2,190.3
Interest on funds held for clients	106.7	—	—	106.7
PEO revenues	939.9	1.4	—	941.3
TOTAL REVENUES	3,235.4	2.9	—	3,238.3
Operating expenses	1,719.3	(19.4)	9.3	1,709.2
Systems development and programming costs	158.1	—	1.3	159.4
Depreciation and amortization	69.3	—	—	69.3
Selling, general, and administrative expenses	717.2	0.5	5.9	723.6
Interest expense	27.5	—	—	