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ADP - Q3 2019 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 consolidated revenue of \$3.8b and adjusted diluted EPS of \$1.77.



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PRESENTATION

Operator

Good morning. My name is Brian, and I will be your conference operator. At this time, I would like to welcome everyone to ADP's Third Quarter Fiscal 2019 Earnings Call. I would like to inform you this conference is being recorded. (Operator Instructions) Thank you.

I would now turn the conference over to Christian Greyenbuhl, Vice President, Investor Relations. Please go ahead.

Christian Greyenbuhl - *Automatic Data Processing, Inc. - VP of IR*

Thank you, Brian, and good morning, everyone. Thank you for joining ADP's third quarter fiscal 2019 earnings call and webcast.

(technical difficulty)

Earlier this morning, we released our results for the third quarter of fiscal 2019. These earnings materials are available of the SEC's website and our Investor Relations website at investors.adp.com, where you will also find the quarterly investor presentation that accompanies today's call as well as our quarterly history of revenue and pretax earnings by reportable segment.

During our call today, we will reference non-GAAP financial measures, which we believe to be useful to investors and that exclude the impact of certain items in the third quarter and full year of fiscal 2019 as well as the third quarter and full year of fiscal 2018. A description of these items and a reconciliation of these non-GAAP measures can be found in our earnings release.

Today's call will also contain forward-looking statements that refer to future events and, as such, involve some risk. We encourage you to review our filings with the SEC for additional information on factors that could cause actual results to differ materially from our current expectations. As always, please do not hesitate to reach out should you have any questions.



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And with that, let me turn the call over to Carlos.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Thank you, Christian, and thank you, everyone, for joining our call.

Before we get started with the earnings discussion, I'd first like to welcome Kathleen to the call and to her new role as ADP's Chief Financial Officer. Kathleen comes to us with a strong operating background, and we look forward to her contributions and partnership as we execute on our transformation initiatives. I also know that she is looking forward to the opportunity to meet with you over the coming months.

Let's now move to a brief review of the quarter. Jan will then take us through the quarter's results in more detail, after which, Kathleen will take us through an update to our fiscal 2019 outlook.

This morning, we reported our third quarter fiscal 2019 results with revenue of \$3.8 billion, up 4% on a reported basis, 5% organic constant currency. This revenue growth was in line with our expectations and continue to be aided in part by the strength of our Employer Services downmarket offerings and multinational solutions.

Our adjusted diluted earnings per share grew 13% to \$1.77 per share and benefited from continued strength in our margin performance, lower adjusted effective tax rate and fewer shares outstanding.

We are pleased with the overall results this quarter, and we believe our performance continues to highlight the underlying strength of our business model.

I'd now like to turn to our sales and marketing initiatives, starting with our solid 10% growth in Employer Services new business bookings for the quarter and then discuss some of our recent sales and marketing investments.

First, we are pleased with our Employer Services new business bookings performance this quarter, which benefited from broad-based growth. With 3 quarters behind us, we feel good about our overall progress this year. At the same time, we continuously work to identify new opportunities and investments in order to leverage our world-class sales force to help drive sustainable growth and build on our position as the leader in the growing global HCM market.

With this in mind, at the end of March, we completed an agreement with a midsized regional payroll services provider to convert their clients to Workforce Now or RUN, depending on business needs and complexity. From time to time, we leverage our scale to engage in transactions like these where we acquire a client list from a third party for the right to sell and convert those clients onto our platforms. While historically not significant enough to call out, this transaction was larger than usual. The timing of this agreement means that while it did not impact our third quarter new business bookings performance, we do anticipate incremental benefit in the fourth quarter of fiscal 2019 from this investment, together with some added expense pressure. We are confident that our sales force and implementation teams are well equipped to capture this new opportunity. However, the timing of the impact from our conversion efforts will depend on the needs of these clients. With that said, as we work to execute on our plans to capture this new opportunity, we are raising our ES new business bookings guidance to 8% to 9% growth for fiscal 2019 from our prior guidance of 6% to 8% growth. This deal was not contemplated in our second quarter guidance, and we believe that even without this new opportunity, we would have achieved at least the low end of our previous guidance range.

Moving on to our recent brand initiatives. At ADP, we have always taken great pride in delivering solutions that help simplify complexities for our clients and their workers. Part of our transformation effort had been to execute towards that goal, and we've continued to make great progress on that front. With this progress in mind, earlier this year, we felt it was an opportune time to launch a new brand platform to better reflect the changes we've been making. This initiative represents an important step in our journey to enhance the employee experience with innovative HCM solutions and insights designed with the worker as the central focus. We carried those thoughts through our brand campaign, which asks What Are you #WorkingFor? In partnership with our clients, we ask them and others to share stories about the world of work through the eyes of their people, bringing to light a range of motivations and passions.



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A key insight from these discussions is that work is about more than what you do. It's about achieving something greater for oneself and others. Our goal in this campaign is to elevate the discussion around the evolution of work and promote a dialogue about what motivates people in the workforce and how we at ADP, in addressing these evolving needs, are always designing for people. This new brand platform and tagline is an expression of what ADP stands for and reinforces our relentless determination to rethink a better, more personalized world at work, so everyone can achieve their full potential.

Continuing on the theme of work, a few weeks ago, I had the opportunity to attend our 26th Annual ADP Meeting of the Minds Client Conference. This event affords us the opportunity to engage in a deeper and broader manner with our larger enterprise clients on their challenges, while also sharing with them our perspectives on the latest trends in HCM, including what we're doing to help employers and their workers tackle these issues. As the world of work changes, the challenges that employers face are becoming increasingly broad and complex. What was clear from the conference is that employers seek a strategic HCM partner, not just a software vendor. They are in need of expertise, someone they can trust and someone who will also help them rise to new challenges in the face of an increasingly complex and fast-paced world of work, one where the war for talent remains intense.

With a record number of attendees at the conference this year, the feedback was very positive throughout the event. Clients and prospects were able to spend time learning about new products and functionality not only from our experts, but also from nearly 40 of our strategic partners, including a record number from our ADP Marketplace.

As a leading global technology company providing HCM solutions, we are uniquely positioned to help employers and their workers, whether it's through solutions that can help them with recruitment to retirement or through our unmatched big data capabilities, I was proud of the reception we received for our continued efforts to deliver innovative solutions with excellent service.

The focus that we're putting on our products and services are only part of our strategy to deliver stronger solutions to our clients. We also believe in a more integrated product strategy and a more open ecosystem. We see shifts not only in how our clients want to connect with us, but also on how workers connect with each other, notably, through collaboration platforms. These platforms are reshaping how people communicate and access information within a company. With product like ADP's virtual assistant bot, employees and HR leaders now have the convenience of a tool that can help them remove friction in the employee experience by allowing them, within the collaboration platforms, to view their pay summary and deductions, make time off requests and more, all while also reducing the time spent by HR and payroll practitioners on low value-added tasks. This allows them to be more strategic and focused on driving business success.

Innovations like these that enhance the employer and employee experience are continuing to help drive improvements in our client satisfaction and net promoter scores, an important element in our ability to reaffirm our expectations of 25 to 50 basis points of improvement in ES revenue retention for fiscal 2019.

Receiving positive recognition for our efforts from both our clients and third parties bolsters our confidence in our investments. Earlier this quarter, we were especially pleased when we were recognized for our vision and strategy by Everest Group, who named ADP a leader in the PEAK Matrix Multi-Country Payroll Outsourcing and Multi-Country Payroll Platform reports and, once again, named ADP a leader and star performer in its annual PEAK Matrix for Multi-Process Human Resources Outsourcing providers. We were also proud to note that we were the only provider selected as both a leader and star performer among the vendors evaluated, underscoring the strength of our position as well as the improvements we continue to make.

In April, we also announced that NelsonHall once again recognized ADP as the overall leader for next-generation payroll services, highlighting ADP's ability to meet future client requirements and deliver immediate benefits to payroll services clients. It's rewarding when influencers and clients alike recognize us for our progress.

Now for one final thought before I hand the call over to Jan. At ADP, we are proud of our efforts to foster a culture of learning and development in order to better attract, train and retain top talent. This is why I was especially pleased this quarter to see that we were once again included among LinkedIn's top companies for 2019. This award highlights the top 50 companies that were most in demand by job seekers, and I'm pleased to say that we moved up 21 places to #20 on this list.



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Overall, our investments in the business are showing positive momentum, and we are pleased with the progress we are making against our objective of driving sustainable long-term growth.

With that, I'll turn the call over to Jan for his commentary on our third quarter results.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

Thank you, Carlos, and good morning, everyone.

Our consolidated revenue this quarter was \$3.8 billion, up 4% on a reported basis, 5% organic constant currency. And as Carlos said, this was in line with our expectations. With that said, we have been seeing more pressure from the impact of FX, which drove approximately 1 percentage point of pressure this quarter.

We continue to see strong momentum throughout our downmarket HCM offerings. In addition, excluding the impacts of FX, we are pleased to see continued underlying strength across our international offerings, in particular from our multinational solutions.

I would also like to remind you of the PEO SUI revenue timing impact last quarter, which also impacted our third quarter consolidated revenue growth by approximately 1% and PEO revenue growth by approximately 2%. There was no impact on our full year revenue estimates from this event.

Our earnings before income taxes increased 12%, and adjusted EBIT increased 10%. Adjusted EBIT margin was up about 140 basis points compared to last year's third quarter and included 20 basis points of pressure from acquisitions. This margin improvement was slightly ahead of our expectation and benefited from a few key drivers.

In addition to benefiting from our early -- voluntary early retirement program, we also continue to see incremental efficiencies within our IT infrastructure, helping to drive improvements in our overall cost base.

Also we continue to execute on a number of tactical and incremental transformation initiatives, which, while none are individually significantly -- significant enough to call out, collectively are helping to drive net productivity improvements across the business. The benefits of -- from these initiatives, together with the impact from our underlying operating efforts, were particular -- partially offset by incremental investments in the third quarter related to the launch of our new brand platform and growth in selling expenses.

Our adjusted effective tax rate was 23.5% and benefited from the impact of corporate tax reform, certain tax credit adjustments and the release of reserve for certain tax positions -- for uncertain tax positions and a small amount of unplanned stock compensation tax benefit. This rate compares to our 24% adjusted effective tax rate for the third quarter of last year.

Adjusted diluted earnings per share grew 13% to \$1.77 and, in addition to benefiting from our margin expansion and a lower effective tax rate, was also aided by fewer shares outstanding compared with a year ago.

Now for our segment results. For Employer Services, revenues grew 3% for the quarter, 4% organic constant currency and were in line with expectations. As a reminder, we had anticipated a deceleration from the first half as we have now lapped the acquisitions of Global Cash Card and WorkMarket, and our revenue continues to be impacted by pressure from FX.

Interest income on client funds grew 24% and benefited from a 30 basis points improvement in the average yield earned on our client fund investments and growth in average client funds balances of 4% compared to a year ago. This growth in balances was driven by a combination of client growth, wage inflation and growth on our pays per control, offset by lower SUI collections.

Also as we mentioned last quarter, we continue to expect lower SUI rates and the impact of FX to put added pressure onto our balance growth for the remainder of the year. Our same-store pays per control metric in the U.S. grew at 3.1% for the quarter.



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Moving on to Employer Services margin. We saw an increase of about 230 basis points in the quarter, which includes approximately 30 basis points of pressure from the impact of acquisitions. This continued strength is a result of the same factors I mentioned earlier regarding our consolidated results, which are continuing to help to improve our underlying efficiencies.

Our PEO services grew 6% in the quarter. And as I mentioned earlier, this revenue growth experienced approximately 2 percentage points of pressure in the third quarter due to the PEO SUI revenue timing impact we experienced last quarter. This pressure was also the primary driver for lower PEO revenues, excluding 0 margin benefit pass-throughs, which grew 2% for the quarter. This timing issue does not impact the full year revenue guidance that Kathleen will shortly discuss. Average worksite employees increased 8% to 554,000 for the quarter.

Overall, we continue to see some positive signs of normalization in the retention compared to the pressure we had seen last year among our larger PEO clients, and we're also starting to see some positive signs from the changes to our sales incentives that we made last year. We therefore maintain cautiously optimistic as we head into our fourth quarter regarding the continued gradual reacceleration of the growth in the average worksite employees, in particular, given the volatility we may experience during our fiscal year fourth quarter annual health care renewals.

The PEO segment's margins decreased 10 basis points for the quarter due to a grow-over pressure from incremental selling expenses and adjustments to our loss reserve estimates related to ADP indemnity, offset by operating leverage within the business and benefits from our voluntary early retirement program. This margin performance was ahead of our own expectations as we continue to see sequential reductions in our ADP indemnity loss reserve estimates as well as lower-than-expected growth in the 0 margin pass-through revenues.

We continue to benefit from the underlying strength of our business model. We remain committed to reinvesting into the business and to leveraging the strength of our organization to drive change. Our results this quarter reflect our success in driving these initiatives, and we are pleased with our progress this year.

And with that, I will now turn the call over to Kathleen for our fiscal year 2019 outlook.

Kathleen A. Winters - Automatic Data Processing, Inc. - Corporate VP & CFO

Thank you, Jan, and thank you, Carlos, for the warm welcome to ADP, and good morning to everyone on the call. I'm looking forward to meeting many of you over the coming weeks and months.

I'll start now with the outlook for Employer Services. We now expect revenue growth for fiscal 2019 to be at the lower end of our previous guidance range of 5% to 6% growth. We narrowed our guidance this quarter since we expect slightly elevated pressures from the impact of FX. And as I will discuss shortly, we have also narrowed down our guidance for interest income from client funds as a result of changes to the forward yield curve this quarter.

We continue to anticipate growth of 2.5% in our pays per control metric. We are raising our fiscal 2019 ES new bookings -- new business bookings guidance to 8% to 9%.

Regarding the agreement that we completed in March, I'd like to highlight that this was not an acquisition of a business. We will, however, be recognizing an intangible asset for the acquired client list. We are not disclosing the purchase price for this asset, but you will see some activity related to this investment in additions to intangibles on our cash flow statement. And starting in the fourth quarter, we will begin to amortize this intangible asset in accordance with our policies for similar transactions.

While we anticipate incremental expense from our brand efforts and the increase in our sales guidance as well as incremental amortization related to intangible assets, we are raising our ES margin outlook and now anticipate full year ES margins to expand about 225 basis points from our prior forecast of 175 to 200 basis points. Our outlook also continues to contemplate 50 basis points of acquisition drag for the year.

Moving on to the PEO. We continue to expect 9% to 10% PEO revenue growth in fiscal 2019 and 8% to 9% growth in average worksite employees. We also continue to anticipate 8% to 9% growth in PEO revenues, excluding 0 margin benefit pass-throughs. With the better-than-expected



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performance in our PEO margin this quarter, we now expect margins to be up 25 to 50 basis points as compared to our prior forecast of at least flat. With the continued reduction in our loss reserves related to ADP Indemnity, we have adjusted our estimate to 25 basis points of grow-over pressure on a full year basis from our prior estimate of 50 basis points.

I'll now go to the consolidated outlook. With the adjustments to our ES revenue outlook, we now anticipate total revenue growth at the lower end of our 6% to 7% range for fiscal 2019. We continue to expect the growth in average client funds balances to be about 4%. We are adjusting slightly our expected growth in client funds interest revenue to about \$90 million from our prior estimate of \$90 million to \$100 million and for the total impact from the client funds extended investment strategy to grow about \$70 million from our prior estimate of \$70 million to \$80 million. The details of this forecast can be found in the supplemental slides on our Investor Relations website.

We now anticipate our adjusted EBIT margin to expand at least 150 basis points compared to our prior forecast of 125 to 150 basis points. This outlook continues to include approximately 30 basis points of pressure from acquisitions.

With the benefits this quarter to our effective tax rate, we are lowering our adjusted effective tax rate expectation to 23.8% for fiscal 2019 compared to our prior estimate of 24.4%. And with these adjustments to our outlook, we now expect adjusted diluted earnings per share to grow 19% to 20% from our prior forecast of 17% to 19%.

We continue to be pleased with our overall execution. And with that, I will turn it over to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from the line of Mark Marcon with Robert W. Baird.

Mark Steven Marcon - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Well, Carlos, Jan and Kathleen, nice to meet you. Wondering if you can talk a little bit about the new type of deal in terms of taking over for existing payroll providers. Just how does that compare to when you win a new client just from an economic perspective? And how big is that opportunity as we look out over the next few years?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Well, in terms of helping you size it, I think that based on the comments we made about our new business bookings, I think you can back into this. It's about a 2 to 3 percentage point impact for the year on new business bookings growth. So that gives you a sense of a book -- from a booking standpoint what the size of the opportunity is and just in terms of elaborating a little bit more on it, we actually do these types of deals on a much smaller basis, on a fairly regular basis, and I've been doing them for 20 to 30 years where small providers that are either retiring or selling out want to sell their book of business. We're not really interested in buying additional platforms or frankly taking infrastructure or offices and so forth. So we structure it really as a -- an agreement where we buy the right to convert the clients. And we get some help and some assistance from the seller. But in essence, it looks a lot like a typical new business, and the economics would look a lot like a typical new business with the exception, of course, that we have to pay some acquisition cost, if you will, to the seller. But the way we organize the effort is very similar to a typical sales effort in the sense that we send out either through our inside sales force or our field sales force people to get the client to sign a contract with ADP because we're not buying contracts and we're not buying the business. So they become an ADP client on our pricing terms and we, in essence, implement them with our resources onto our platform. So it looks a lot like business as usual. The reason we had to call it out is obviously the size. These typically are frankly really small. A couple thousand, couple -- even in the hundreds of clients. It's a CPA firm or an owner of a small payroll company may be retiring. This is a much larger transaction that it has a material -- somewhat material impact on our results and our guidance and we thought it was important to point out. We were being a little bit coy about the details because, obviously, for competitive reasons, we are literally right in



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the middle of converting all these clients. So our sales force has already been out for several weeks "selling and converting" these clients, and we've begun the implementation process. But most of our competitors are aware of this transaction that was going on, so they're going after those clients as well. So we'd just rather not talk about it more than we have to just to make sure that we give you the proper context and the proper guidance.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I just meant from a strategic perspective longer term, do you see more of these types of opportunities coming up as you and some of the other large national players have invested more behind technology and smaller regional players just can't keep up?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Yes. I wouldn't call this a small regional player. So this is probably -- as you get more information about it, I think it will become obvious. This is kind of the last of its kind as far as I'm aware. And just for historical purposes, I was personally involved. In 2007, it was the first time that I met with this organization about trying to create an opportunity for us to acquire this business or, in this case, the rights to convert these clients. And there were people before me who had already been having those discussions. So this has been going on for quite a long time, so I would say this is in the category of relatively unique and -- in terms of size and also type of -- the type of payroll provider that it is.

Operator

And our next question will come from the line of Jason Kupferberg with Bank of America Merrill Lynch.

Jason Alan Kupferberg - *BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst*

Just wanted to ask a follow-up on that point with this new agreement. Is there anything baked into the revenue guidance for the year? And can you give us a rough sense of how many clients this involves? And then just was there any promotional pricing or any extra promotional pricing in Q3 to help fuel the bookings rebound that we saw, the 10%?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

There was nothing incremental in Q3 and sort of just answering that question first, which I think is somewhat unrelated to the other question. So the answer to that is not that I'm aware of. There was no -- nothing artificial done or nothing -- remember, part of -- tried to explain, in the second quarter and, hopefully, this is some indication that we were giving you guys the right story, is that calendar-wise, we had some -- a couple of days of selling that moved into the third quarter from the second quarter. So if you remember, we had a relatively weak second quarter new business bookings. So I think some of it is calendar. Frankly, it was even better than we expected based on just the calendar explanation. So I think it was just an overall good rebound and good performance. The -- in terms of the size of the transaction, the impact on revenues, just because of the mechanics that our business operates on. As I mentioned, our sales force is literally, right now, getting sales orders, converting the clients. And we have implementation people starting the implementation process. We have implemented some clients, but it was -- it's an insignificant impact on revenues for the fourth quarter, but a significant impact in bookings -- in new business bookings, which is why we've adjusted the guidance the way we have. The other factor that I would mention is as you do your work on margins and so forth and you might notice some pressure in the fourth quarter, there's also, again, typical of the way our business works, we have a significant pressure from an expense standpoint in the fourth quarter as a result of incremental selling expense. And in this case, we also have the amortization of the intangible without the offsetting "revenues" because they haven't started yet. Some of them have started, but most will impact our revenues in the first quarter and beyond of next fiscal year. So it's a meaningful headwind from a cost standpoint. And then the other thing just to keep in mind is if you recall, last year's fourth quarter, we had very, very strong margin improvement. So the comparison is difficult, plus we have this fairly significant expense pressure from this transaction, which is -- obviously hurts us in the fourth quarter and it's slightly dilutive. I think we've figured it's a couple of pennies, I think, we've talked about.



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Kathleen A. Winters - Automatic Data Processing, Inc. - Corporate VP & CFO

Yes, a couple of pennies in the fourth quarter.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

But it will help us, I think, on a go-forward basis because, obviously, by the first quarter, almost all of that selling expense will have -- and implementation expense will be behind us. The amortization expense will still be with us, but most of the acquisition and implementation expenses will already be behind us. And then we'll have the revenue and incremental margin from that business. So again, had we, just to make sure that we don't overcomplicate this, if we had a -- which we've had in the past, if we had, had a blowout fourth quarter sales result, it would be about the same discussion. We would have had a lot of incremental selling expense and implementation expense, and it would be good news for future growth and for revenues, but it would be pressure in the short term on the earnings.

Jason Alan Kupferberg - BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst

Right, right. So that kind of leads to my follow-up question just on margins because, obviously, the execution continues to be very strong there. So you were absorbing some of these incremental costs, yet you did raise the guidance again for margins for this year. So I wanted to talk a little bit about just your plans to backfill some of the roles that are being vacated or have been vacated by the early retirement program, how you're thinking about that now versus what you've initially envisioned in terms of a backfill percentage.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

It's a great question. I think the way that I look at it just from a 40,000-foot level is, really, headcount growth year-over-year because there's so many other pieces of noise, like this incremental expense pressure we have in the fourth quarter. The best way to really kind of -- given that our -- most of our expense that's really people-related is really FTE growth year-over-year. And I think on that basis, as we expected and as we predicted, and as we encouraged our organization to do, we closed some of the gap that we had in the first quarter by the third quarter. So we're still ahead. We wouldn't be increasing our guidance if we hadn't been still ahead. So we're still a little bit ahead of where we thought we would be in terms of not backfilling as much as we expected, but we closed some of that gap. Now that was the appropriate thing to do because we want to make sure that our client retention, our client satisfaction, our NPS scores stay -- I think it's a record -- at the record levels that they are in some of our business units. So that was an important objective for us, which was to extract incremental margin and efficiency out of the organization and out of the business, but at the same time, making sure that we stayed focused on client satisfaction and client service. So I think we're doing that. I think we've landed the plane in a fairly good place. I think the organization responded well, I think, to the absorption of the early retirement reductions as well as the reworking of some of the things that we do and some of the processes that we have in order to make sure that we can continue to deliver the high levels of service that we have with fewer people.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And maybe I'll add with -- nuts and bolts. As a reminder, we anticipated the impact of the voluntary early retirement program to have an annualized impact of approximately \$150 million. And we are anticipating that to be true going forward. So the overall opportunity has not increased, but we captured in this fiscal year a higher percentage of that total number, which we now expect slightly to be below that, like 140 -- I would say, roughly \$140 million to \$150 million. So we think, Jason, that the overall assumptions regarding the back hiring and the backfill remains intact.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

And I think in terms of new context, this was a fairly large undertaking that we hadn't been through before. So I think in the context of the guesswork that went into the backfills and the pacing of those backfills and so forth, I think the organization did a great job.



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Jason Alan Kupferberg - BofA Merrill Lynch, Research Division - MD in US Equity Research & Senior Analyst

Okay. Jan, best of luck to you. And Kathleen, look forward to meeting soon.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

Thank you.

Kathleen A. Winters - Automatic Data Processing, Inc. - Corporate VP & CFO

Likewise. Thanks.

Operator

And our next question will come from the line of Jim Schneider with Goldman Sachs.

James Edward Schneider - Goldman Sachs Group Inc., Research Division - VP

And congratulations to both Jan and Kathleen. Maybe just to start out, maybe, Carlos, could you provide a little bit of color on your view on where the PEO market demand stands right now? Anything that you're seeing that makes you kind of more or less encouraged about the demand outlook and your ability to kind of sustain the same pace of growth over the next few quarters as you have seen? And maybe kind of give us any color around the comment that I believe Jan made on the kind of cautious optimism around the health care renewal season.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

The -- no, I think from a long-term strategic standpoint don't really see any changes from what we've seen for the last, honestly, couple of decades, which is kind of the underlying environment of increasing complexity for small employers and, even in this case, midsize employers, I think, continues to be a reality. I think the war for talent, I think, just adds to that dimension of small and midsize companies now -- on top of having to deal with regulation and complexity and so forth. And it's a -- it happens in every administration. We've seen now this administration obviously has a different view of regulation, but there's still a lot of activity, like the recent announcement around changes in overtime regulations that had been previously announced under the Obama administration. So the world continues to become difficult and complex for small and midsize employers. And then on top of that, very low unemployment rates create a real competitive issue for people to find talent. So all of those things, I think, are fuel for kind of the long-term strategic growth of the PEO model. So there's really nothing that I see that's changed that potential and that trajectory. There's still relatively low penetration, whether it's at the ADP client base level or even out in the marketplace. The number of clients on PEOs relative to the available market is still relatively small. There's obviously noise along the way. As Jan mentioned, we have a health care renewal in the fourth quarter, but we have that every year. We have year-end, which tends to create a lot of activity as well. By that, I mean, January 1, which that's now behind us this year, but that occurs every year. You have other kind of events that happen along the way, like ACA. It was an event that, I think, had an impact first positive and then slightly negative afterwards in its wake. So there are things that will create ups and downs. But overall, we're still very bullish on that business in the -- in terms of the long-term outlook.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And on the short term, Jim, you were following up on the specifics of the health care renewal. I think we don't see anything specifically positive or negative on this health care renewal. So it's kind of -- there are always changes by carrier as we receive the proposals. But that feels like largely in line with the historic trends that we have seen.



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James Edward Schneider - *Goldman Sachs Group Inc., Research Division - VP*

That's helpful. And then as we think about the kind of go-forward impact of the book of business you're taking on, can you maybe help us a little bit as we model a forward model in terms of, for example, over the next quarter or by the end of June, if you size the rough number of clients you expect to kind of be able to convert, what percentage of those clients you think you will be able to sign up of the total by the end of June?

Jan Siegmund - *Automatic Data Processing, Inc. - Former Corporate VP & CFO*

I think the easiest way, Jim, to think about it is we increased our guidance and you got the -- basically the incremental number from Carlos today. If you translate those new business bookings, they will be kind of -- they're largely smaller clients. And we anticipate an almost full run rate of revenues for next year. So you just translate the incremental new business bookings into ES, they're all ES clients, and then they will become revenues. Like 1% of new business bookings growth, Christian, reminds me, is approximately \$15 million of revenue, so that gives you a good -- I think that gives you a fair sizing of the opportunity.

Operator

Our next question will come from the line of Ramsey El-Assal with Barclays.

Ramsey Clark El-Assal - *Barclays Bank PLC, Research Division - Research Analyst*

I wanted to ask you about the pricing environment. I think you mentioned last quarter, it had firmed up a bit. And I just was wondering if you could update us on any pricing trends that you're seeing more recently, maybe end of the year and selling season.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

In my advanced age, I'm -- yes, you're right. We talked -- by pricing, you mean, we said that our promotions were down year-over-year. And I think that was a sign of maybe things firming up. I would say that the information this quarter is not consistent with that. So I think if you look at the full year now after 3 quarters, we're probably like around the same place we were in the previous year. So again, that's why sometimes it's better to not say much because it looked like maybe there was some kind of trend there. But I would say, there's really no -- there's no trend. I think that we don't see any major, unless Jan has or Christian has any other observations. But I think -- because we get so much information and so much data to prepare for these calls that sometimes we get too much into the weeds. And so there was some signs of the use of less promotions in the first 2 quarters of the year. And I think, now, when you look at it over the course of 9 months -- and by the way, our heavy selling season is the third quarter in one of our businesses where we sign up a lot of the clients as of the beginning of the year. So I'd say there's really probably nothing meaningful to report. Is that a fair...

Jan Siegmund - *Automatic Data Processing, Inc. - Former Corporate VP & CFO*

I think that's fair, yes.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

So by the way, we're not -- for whatever that's worth.



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Ramsey Clark El-Assal - Barclays Bank PLC, Research Division - Research Analyst

Great. Terrific. On just a broader macro question. Are you seeing any changes, any updates on the broader macro environment maybe sort of a slice there kind of U.S. versus non-U.S. business, maybe particularly Europe? Is there any interesting call-outs there to report? Or is it just sort of you still see a pretty smooth macro environment sort of unfolding?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Yes. So I felt -- I think it was a couple of quarters ago where I got a question, I gave a very short answer about nothing, anything going wrong in the economy. And then I looked like I was going to have egg on my face in December and January. But maybe we're now somewhat vindicated in terms of our data has been consistently showing, I think, the economy continuing to move along at a very good pace. And so I think, today, we -- the National Employment Report came out. You see our pays per control number and you see government GDP reports a few days ago. And I think all of those were consistent with, I think, an economy that's performing quite well. And so I would say we would stick to the same -- I won't be quite as cavalier anymore about making economic predictions, but we don't see any real change in the current trends. Obviously, Jan and I have been saying this for a couple of years, and I think we've so far been proven wrong that with unemployment as low as it is, the growth in the amount of employment at some point should slow. But it appears that there's enough people on the sidelines, just based on the labor participation rate number, that people are still being drawn into the workforce. The one thing that we will point out is we've seen, like the government and others, some wage pressure, which actually is good for us. We kind of like wage pressure, not necessarily because of the pressure it puts on our cost internally, but our float business benefits some -- a little bit from higher wage inflation, obviously, because it increases our balances. It's not a meaningful number given how much inflation we've had, but the trend has been up for multiple quarters now. But I think it's all -- it seems like the economy is performing very well. We look at all the other indicators that everyone else looks at, like NFIB optimism, leading indicators, all the other Michigan leading indicators, all those other things, I think, all look very strong.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And if I add 2 seconds on our European business. The last 3 months in Europe actually were also stronger relative to our pays per control metric. So I wouldn't overread it, but it was a very solid European quarter also.

Operator

And our next question will come from the line of Lisa Ellis with MoffettNathanson.

Lisa Ann Dejong Ellis - MoffettNathanson LLC - Partner

And welcome to Kathleen. I wanted to ask just a broader question about the competitive dynamics and ADP's performance in the mid and upmarket. You've called out continued strength in RUN and international as drivers of growth. Those have been bright spots for ADP for a long time. Can you just give us an update? I think we're now well over a year past the completion of the Workforce Now migrations. Are you back to positive client growth in the midmarket? And then also what's just the update on, like, the new payroll engine and sort of the long-term strategy to improve your competitive position in the upper end?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

So when we made the comment about the strength coming from small business and international, it was actually multinational is what we said in our prepared remarks. We were referring to revenue, if you'll recall, which is accurate and actually makes sense. But on our bookings, I think we also said that we had broad-based new business bookings performance that led to the 10% growth. And so by broad-based, we would include the midmarket and the upmarket. So we've gotten some help from the decision to deploy and sell more aggressively Workforce Now in the lower end of the national accounts market where -- for clients that are in kind of the less complex range, if you will, and smaller size, so call it 1,000 to 5,000



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employees and less complex. So that's given a little bit of a boost to our upmarket sales. I think in the midmarket, when we look at our midmarket business kind of across categories because we have our traditional payroll business, but we also have a fairly fast-growing midmarket business within our PEO because our PEO sells also to midmarket clients. So some of those incentives that we talked about a couple of quarters ago have started to kind of have the desired impact and we've had a little bit of a rebound in the growth of our midmarket PEO business. We also have a midmarket outsourcing business that doesn't have (inaudible) we've had it for many years, but that's also a fast-growing business as well. It's within the HRO segment when we talk about the strategic pillars. So it's kind of a sister business, if you will, to the PEO. So when you add all those together, I think we feel pretty good about our performance in the midmarket. I think our bookings were very good in the third quarter in the upmarket. And I think when you add in GlobalView and some of our other solutions in the upmarket, like standalone tax, like, we feel okay about -- as you know, we've been very transparent that this is a place where we have work to do and we still think we have some work to do in the very -- in the upmarket domestic business. And our new platform we affectionately refer to as Lifion, I think, is intended to help boost that. And I think the combination of Lifion, Workforce Now and Vantage, I think, really are positioning us for a much stronger position in the future than what we've had over the last couple of years.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And if I add to this, we have seen continued improvement in our client satisfaction and retention, in particular, in the midmarket. We're seeing the benefit of being on one platform, clients staying longer. And now, for many quarters in a row, midmarket retention has really improved overall. And so the midmarket -- it feels to me, the midmarket compound of all of these factors together is a much stronger position than it was just a few quarters ago.

Lisa Ann Dejong Ellis - MoffettNathanson LLC - Partner

Terrific. And then as maybe my follow-up. You'd called out you're now lapping Cash Card and WorkMarket. Can you help a little bit with where those are starting to plug into your business and how big contributors they are today?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Well, I think that, again, unfortunately, for -- or fortunately, depending on how you look at it, for ADP, the Global Cash Card had a -- certainly a measurable impact just because of the size. And I think we've disclosed the size of that acquisition and I think the revenue impact. But generally speaking, some of these acquisitions tend to have long-term strategic value. I think Celergo, which you didn't mention, but it's another one that I would bring up. We'd expect that to really have a big impact on our multinational business in the future, but it's just -- because of the size of ADP at \$14 billion, these acquisitions just are more strategic rather than kind of short-term financial impact plays. On the Global Cash Card side, that's a place where we're very, I think, bullish in terms of the future of using the pay card, I think, as an avenue for growth because we have a very large installed base that we think will fit -- that, that solution will fit well for. And I think it's a -- there's demand out in the marketplace for it. I think WorkMarket, as we've said, there's a huge market. If not the size -- close to the size of kind of our traditional ADP W2 business for independent contractors, but it's a very, very small impact in the current fiscal year and probably for the next couple of fiscal years. And so how we're -- what we're doing with these products, as an example, in the case of WorkMarket, we're building WorkMarket into Lifion. And so you will have a platform available to clients in the upmarket that will allow them to manage their entire workforce, their W2 employees as well as their independent contractors to have full visibility of their entire workforce. So that -- that's an important, I think, move that we've made to use the intellectual property and leverage that intellectual property. And then in terms of how we're building the Cash Card business in terms -- into the future is, I think, we've kind of signaled that we think we have an opportunity to create a larger relationship with the worker. And so this concept of B2B2C, I think, is something that Global Cash Card and, Wisely specifically, gives us, I think, an entree into them. So again, that's something that -- it's 3, 5, 10 years down the road, but we're very excited about it.

Operator

And our next question will come from the line of Tien-Tsin Huang with JPMorgan.



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Tien-Tsin Huang - JP Morgan Chase & Co, Research Division - Senior Analyst

Just one question on margins because you're running ahead with the raised guidance. I'm curious if this changes your thinking on margins or investments in relation to your longer-term targets on margin expansion.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

So I think we traditionally provide guidance in August. And so I think that would be the tradition we will stick to. So we -- we are -- I think we're in the middle of our operating plan season here and that will obviously give us a little bit more visibility into '20 -- into fiscal year '20, which [will then gear] in August. We gave 3-year guidance. And I think our intention wasn't to update it quarterly. And I think when we get to, I think, the guidance for fiscal year '20, we'll see, I think, what that implies in terms of the guidance.

Tien-Tsin Huang - JP Morgan Chase & Co, Research Division - Senior Analyst

Got it, so we'll stay tuned for that. Jan, all the best to you. And Kathleen, look forward to working with you.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

Thank you.

Kathleen A. Winters - Automatic Data Processing, Inc. - Corporate VP & CFO

Thank you. Likewise.

Operator

And our next question will come from the line of Ashwin Shirvaikar with Citi.

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst

Kathleen, welcome. Jan, it was a pleasure working with you. All the best. I guess my first question is in both ES and PEO, you seemed to have clarity -- you seem to be trending more to the lower end of revenue expectations. You did well on margins. I want to ask how you're now thinking of sort of the revenue growth versus margin growth trade-off. All these margin initiatives have been successful, but is it leading you too much in one direction versus the other? And specifically, what do you need to do to get up to your 7% to 9% midterm growth rate?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

So I'll mention 2 things. First, on Employer Services, I think we tried to be clear that we have a little bit of additional FX pressure, which is obviously something that we don't have control over and we don't factor in, in the beginning of the year. So I think that's a -- at least for now, that's some of it because you would see from our third quarter bookings that we feel pretty good about the long-term future trajectory from a revenue growth standpoint. On the PEO, I think, we've cautioned, I think, over many years and even when we did our Investor Day that a very large part of our guidance around PEO revenues and overall ADP revenues is the growth of pass-throughs, which has no impact on dollars of profit. It has an impact on margin because the slower those pass-throughs grow, they actually help us with our margin percent objectives. But the faster they grow, the more they hurt that margin. And so we've cautioned and encouraged people to not get too caught up if the source of weakness is pass-through revenues. It's really not a value-creating revenue stream for us. It's a part of the way we -- the business model and it's part of the way we bill our



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clients. But I would say that the tone you should be hearing from us on the PEO is actually quite positive. It has been positive since the first quarter and was positive even entering into the first quarter. And the only thing that changed from 6 months before that was the pace of pass-through growth, which slowed in a meaningful enough way that it put pressure on the top line revenue growth for the PEO. But I will encourage you to stay focused on kind of the revenues, excluding pass-throughs and worksite employees and the other metrics, which we feel are actually strong, if not ahead of where we expected them to be.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And maybe I'll add a more tactical comment because this quarter really had an unusual revenue growth outcome. And just reminding everybody that much of that in the PEO, of course, we explained with the timing of SUI revenue collection and a couple of other onetime moving items also and we had also a timing effect of revenue relative to processing days in the second quarter that moved into the second quarter on the ES side. So once you adjust for all of that, actually, the organic revenue growth rate for the company is fairly close to where we want it to be. And if you look on a year-over-year comparison, I think we remain optimistic about an acceleration of our organic revenue growth, in particular in the ES segment, that should really drive overall long-term success of the company. And as you know, we have built in scale in our business model, a growing company that shows competitiveness. So there's a strong commitment to drive the revenue growth as we had indicated going forward.

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst

Got it. I did want to go back to the transaction that you announced with, what I think is a larger bank distribution channel. Without that, I believe you said you'd be at the lower end of the bookings range. Is there something going on there with regards to competition, prior year comps, pricing, something we should be aware of that is temporarily affecting that bookings performance? And typically, when you buy these sorts of portfolios, I'd imagine they don't quite have the richer set of portfolio services you have. So is that an opportunity?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Yes. The last part of your question is there's definitely an opportunity there because you're right, our portfolio is a little bit broader. So we -- we're very bullish and very optimistic on the transaction. Just to clarify. We didn't say that we would be at the low end. I think we said we'd be at least at the lower end. And so we feel -- based on the third quarter bookings performance, based on momentum, we feel pretty good about our situation around new business bookings. So maybe we weren't strong enough in conveying that, but I think our sales force is executing quite well. I just want to clarify also, it may not have come through, that I've been working on this deal for -- personally for more than...

Ashwin Vasant Shirvaikar - Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst

2007, yes.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Ten years. And I think the company is working on it before. So we didn't just run out and try to make an acquisition to make the quarter or to get our bookings number up for the fourth quarter. I wish it were that easy because we tried many, many times to make this happen over the course of a decade. And this happens to be when it -- when it occurred. And we would have taken it any time, any day because it's good for our shareholders and it's good for our business. And we're very pleased that we have it. But no, we have no concerns about anything happening in the macro environment, on the pricing front or otherwise to make us feel less positive about our sales force, our distribution and our new business bookings.

Operator

And our next question will come from the line of James Berkley with Wolfe Research.



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James Robert Berkley - Wolfe Research, LLC - Research Analyst

And congratulations, Jan and Kathleen. Just a quick follow-up on the bookings side. Obviously, great seeing the guidance being raised. Just how big was the days of selling impact? Since there was no discounting, just trying to understand the acceleration. I know, like holiday sales and January, a lot of people struggled across a lot of different industries there. But just trying to get a feel for the current trend and how sustainable that is, excluding the impact of the transaction you're expecting in the next quarter.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

If I remember correctly, it would be the same impact that we talked about -- that impacted the second quarter because we just -- we ended up getting, I think, it was 2 days of less selling in the second quarter, which then we got in the third quarter. And we saw it -- if you remember the conference call that we had -- we already had, had those 2 days. So we knew we could see that our sales in the first couple of weeks of the -- of this quarter had kind of rebounded. And I think it was a few percentage points, if I'm not mistaken. And I think it was 2 to 3 percentage points of impact on the second quarter, which means we probably got a little bit of benefit to that extent in the third quarter.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

And this timing event overall didn't really impact our full year outlook for the -- for new business bookings. So it was really neutral. And everything we thought we lost was made up, as precise as you can be in these things, was made up in January.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

I think it's fair to say that if you take all the noise out of the calendar and so forth that we feel like we're right where we thought we would be in terms of bookings, in terms of where our plans were and where our objectives were.

Christian Greyenbuhl - Automatic Data Processing, Inc. - VP of IR

James, I would just remind you, like, we talked a little bit about FX, right, and we also talked about interest income being a little bit weak. So if you're talking about the context of the strength of revenue growth, just keep those 2 items in mind.

Operator

So our last question will come from the line of Kevin McVeigh with Crédit Suisse.

Kevin Damien McVeigh - Crédit Suisse AG, Research Division - MD

Is there any way -- and congratulations again on both Jan and Kathleen. Think about the impact of the retention across -- so the 25 to 50 basis points of that, how much has that come kind of from downmarket versus mid versus up as we're thinking about the year, overall?

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Well, obviously, we don't provide retention by business unit. But maybe we can give you some -- I think we already gave you some color or some sense of that. I think Jan talked about some really good improvements in our midmarket business. We do have obviously a number of other businesses besides kind of the general categories of small, medium and large. Like for example, in the downmarket, we have a retirement services business. We have an insurance business that really acts as an agency in addition to the traditional payroll business. We talked about the outsourcing



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businesses that we have that are in Employer Services, but are not part of the PEO. So these kind of more comprehensive solutions, if you will, that those are -- those businesses have gotten to be a meaningful size. As well, we have a screening and selection business. We have an RPO business. So we have a lot of moving parts. And I think, for us to get improvements in retention, we have to have broad-based improvements in client satisfaction, in NPS scores and execution. It's just there's no way around it. So you have to assume that -- by the way, we've -- for the last -- as long as ADP has been around, we have some people that are performing better, any particular quarter or any particular year, and others that are performing less well. But when you see this kind of trend, you have to assume that the overall company is performing better and executing well, which is what is happening.

Kevin Damien McVeigh - *Crédit Suisse AG, Research Division - MD*

That's super helpful. And then just on the acquisition, are the clients mostly kind of down, mid -- or enterprise or across the board and historically has it been kind of more of a service? Or are they already on the cloud or you'd shift them to the cloud as you're kind of bringing them in?

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

It's small and mid, which is traditionally the way these -- these acquisitions are typically in that space, it's -- and technically not acquisitions just to be clear. This is, remember, the right to convert the clients onto our platforms from their previous providers. So these are typically -- I don't think we've ever been able to do -- who knows, but we've never been able to do this with kind of enterprise-sized clients. I guess it's technically possible just to buy the right to convert. But this typically happens with mid -- with small and midsized clients. The majority of the clients would be small clients and some midsized clients.

Operator

This concludes our question-and-answer portion for today. I am pleased to hand the program over to Carlos Rodriguez for closing remarks.

Carlos A. Rodriguez - *Automatic Data Processing, Inc. - CEO, President & Director*

Thank you. So as you can tell, I think, from our comments, we're really pleased with the rebound in our bookings. We're happy with this transaction that we consummated in late March. I think we have good momentum. I think our financial performance has been strong. But I also want to kind of call out the comment and the question about retention. We really wouldn't be able to perform on a long-term basis as well as we're performing if we weren't really delivering strong client satisfaction and better products. So I want to also compliment our associates and our organization on staying focused on NPS scores, on client satisfaction and our -- and on building stronger products because the performance of the financial side doesn't come without those factors. And all while we're doing that, we're trying to transform our business and I think become more efficient, so there's a lot of effort and a lot of work, and I appreciate all that everyone is doing. Last thing I just want to mention is, obviously, very excited about having Kathleen here with us. And everyone will get to know her. But it's a bittersweet moment here with Jan leaving. As always, even the way he handled this transition, was a total class act. So we've been partners here for a long time. Prior to us being either CEO or CFO, we've been through a lot together. We've done a lot, and I just want to thank Jan one more time for everything he's done, not just for our shareholders and for all of you who are here on the call, but he also did a lot for our clients, our associates. And he did quite a bit for his community as well. So Jan, I thank you, again, and I declare you not only Iron Man athlete but Iron Man CFO.

Jan Siegmund - *Automatic Data Processing, Inc. - Former Corporate VP & CFO*

Thank you.



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Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

Thanks for everything, Jan. Good luck to you.

Jan Siegmund - Automatic Data Processing, Inc. - Former Corporate VP & CFO

Thank you, thank you.

Carlos A. Rodriguez - Automatic Data Processing, Inc. - CEO, President & Director

And thank you today for your attention. Appreciate it.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and we may all disconnect. Everybody, have a wonderful day.

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