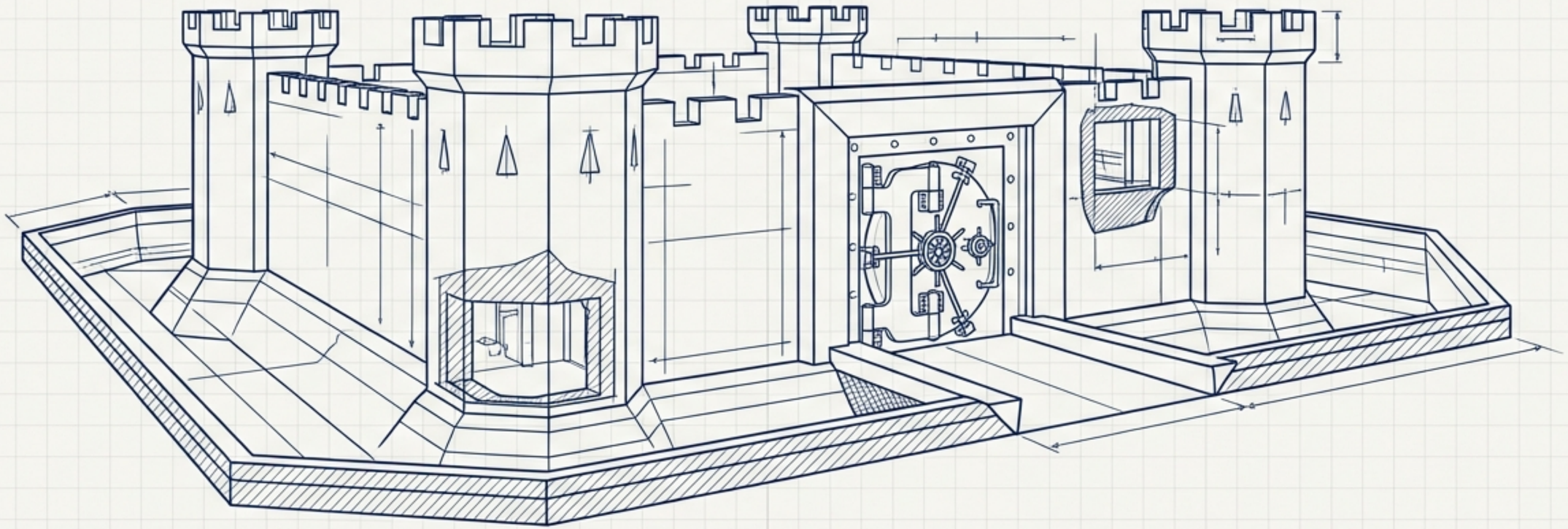
CONFIDENTIAL DOSSIER
SECTOR: HCM SOFTWARE
TICKER: NASDAQ:ADP

ADP: A Fortress Business at an Inflection Point

Analyzing the asymmetrical risk/reward of the global HCM incumbent



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The Fortress

- **92.1%** Client Retention (near record highs)
- **50%+** Unlevered ROIC
- **AA-/Aa3** Credit Rating
- Processes 1 in 6 U.S. private-sector paychecks

The Cracks

- **3%** New Business Bookings (lowest non-recession growth)
- Float Dependence (22% of EBIT driven by interest rates)
- PEO Margin Compression (14.8% down to 13.7%)

The Catalyst & Resolution

- Lyric HCM Platform Launch
- Current Valuation at ~20x trailing P/E (vs. 29x 10-year avg)

The Thesis: ADP trades near a decade-low valuation floor that heavily prices in macroeconomic and competitive risks, offering asymmetric upside if its strategic pivot to the cloud-native Lyric platform succeeds.

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Employer Services (ES) — The Engine

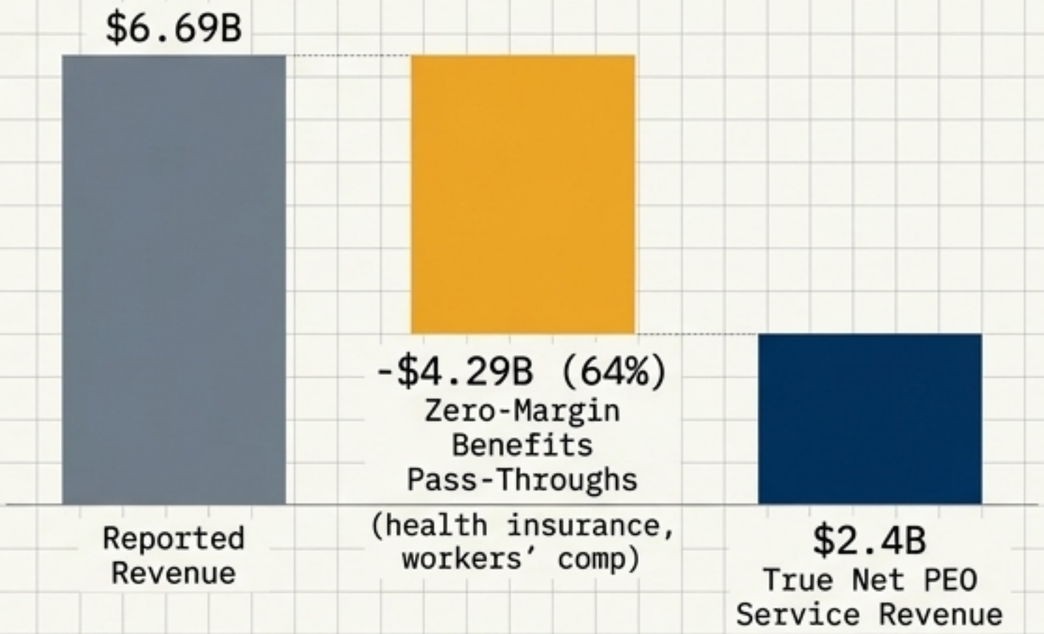
$13.9 Billion
Revenue (67% of total)

36.1% Adjusted EBIT Margin

Average client tenure ~10 years

Pure recurring software/services revenue

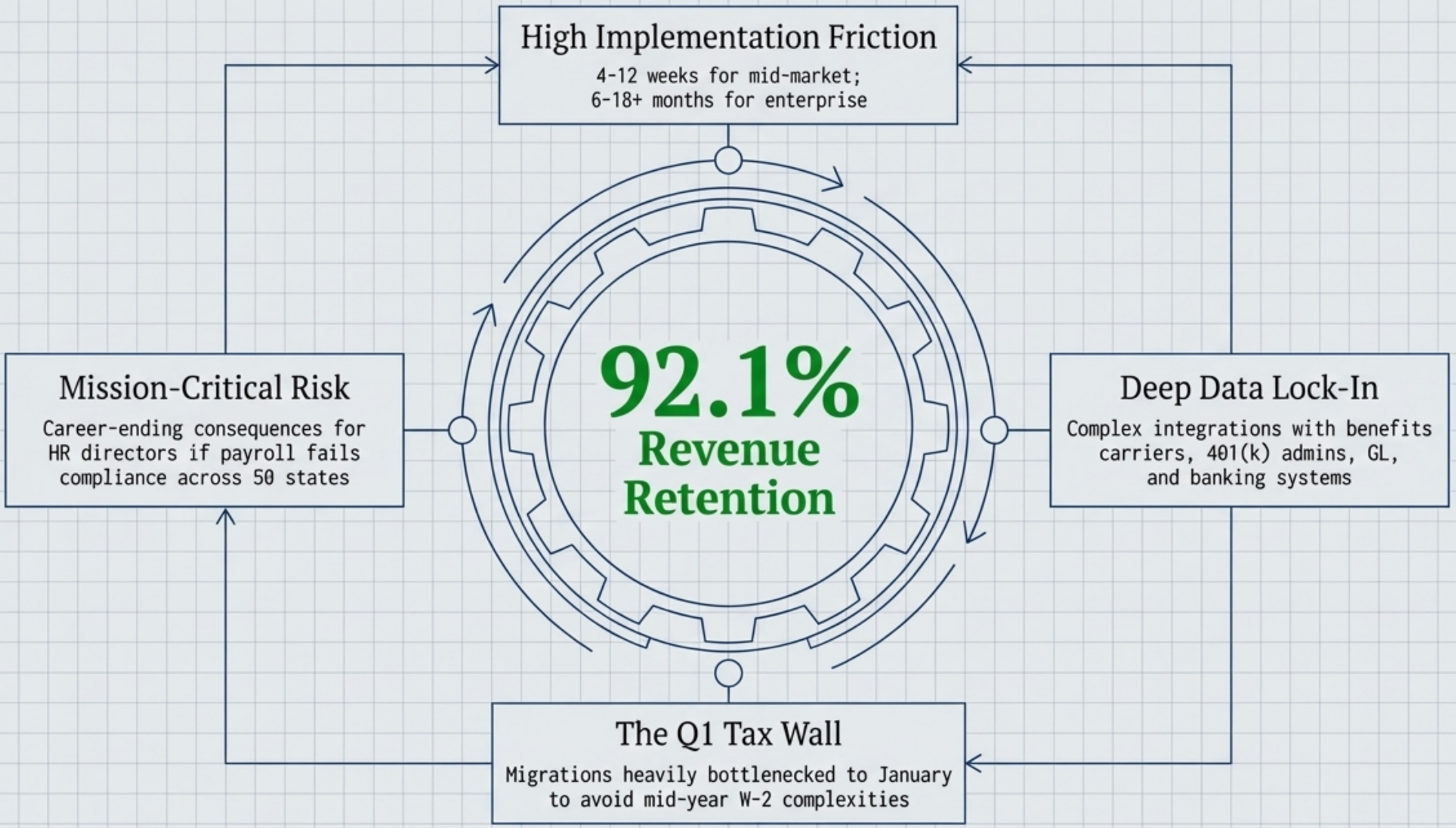
PEO Services — The Illusion



Structural Margin: 14.2%

Insight: While **PEO inflates headline revenue, Employer Services (ES) is the true engine of quality**, generating 36.1% margins vs. the PEO's structural 14.2%.

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Competitors are winning net-new business formation, but structural switching costs prevent mass defection of ADP's 1.1 million existing clients

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DuPont Decomposition

Inflated by aggressive historical share repurchases shrinking equity to $4.5B

Reported ROE: ~73%

Net Profit Margin: 19.5%

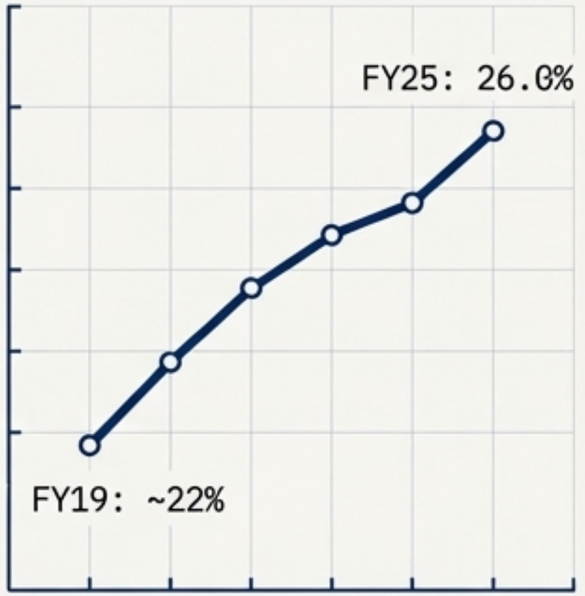
Asset Turnover: ~1.28x (excluding client funds)

Financial Leverage: ~3x (corporate basis)

Unlevered ROIC: ~50%

Margin Leverage

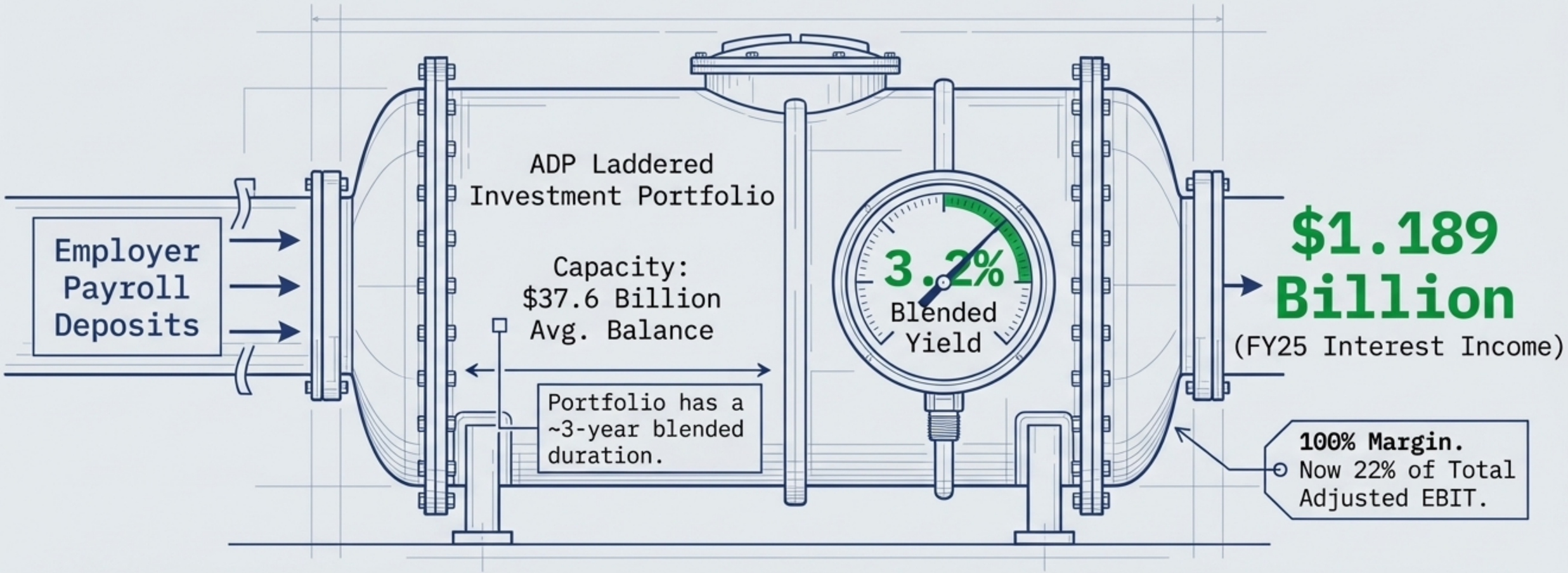
Adjusted EBIT margin



Incremental margins consistently hit 34-37%, proving genuine operating superiority, not just financial engineering.

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The Float Income Engine

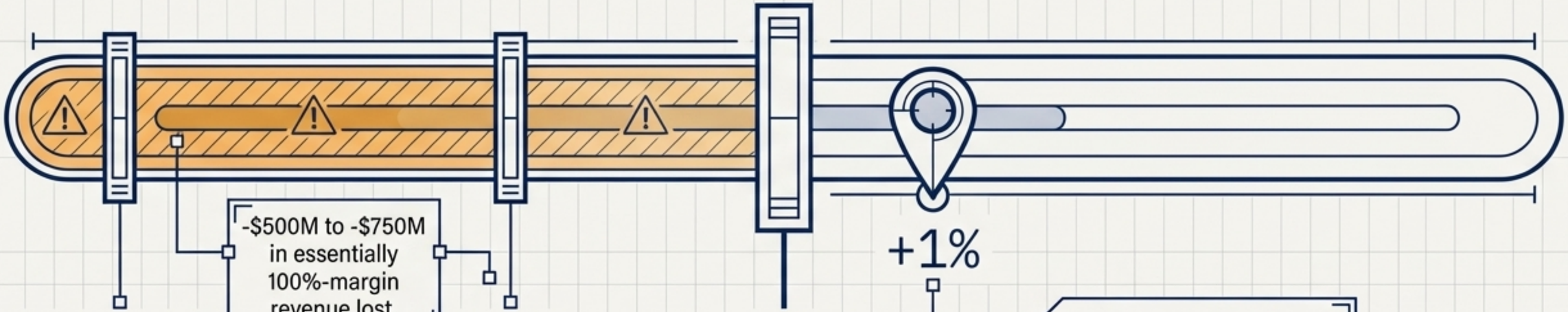


Risk Readout

The Exogenous Vulnerability: A 200bp Fed rate cut drains this tank by $100-$150M in Year 1, expanding to a $400-$500M steady-state earnings hit as the portfolio rolls over.

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The “Pays Per Control” Sensitivity Gauge



-10.8%
COVID Q4
FY20 Trough

-5%
2008-2009
Recession Level

0%
Stagnant
labor market

Despite these historic shocks, ADP never experienced a year-over-year revenue decline. FY09 revenue grew 1%, and FY20 grew 3%, shielded by its ~90% recurring model.

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The HCM Competitive Matrix

Company	Target Market	Operating Margin	ROIC	Revenue Growth	Core Architecture
ADP	SMB to Enterprise	26%	~50%	~7%	Multi-database legacy transitioning to single
Paychex	SMB / Mid	~42%	~26%	~3-4%	Mixed
Paylocity	Mid	~20%	~15%	~15%	Cloud-native, single database
Paycom	Mid	~28%	~25-30%	~10%	Cloud-native, single database
Workday	Enterprise	Inflecting	N/A	High	Cloud-native, single database

VULNERABILITY:
ADP is notably absent from the Gartner Magic Quadrant Leaders for Cloud HCM Suites—its most glaring competitive liability.

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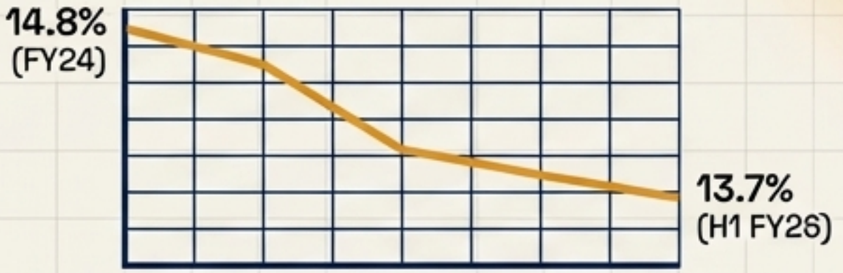
Risk Radar: Key Business Vulnerabilities & Headwinds

1. Bookings Collapse

3%

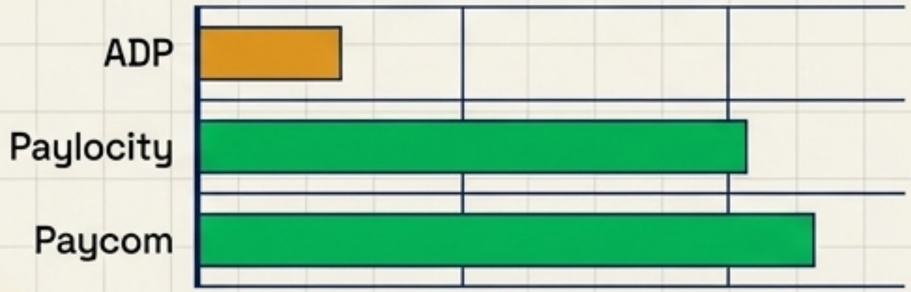
FY25 new business bookings missed 4-7% guidance, marking the lowest growth rate outside a recession. Deal cycles have lengthened.

2. PEO Squeeze



Healthcare cost inflation is running ahead of pricing power, mirroring competitor Insperity's descent into losses.

3. Cloud-Native Erosion



Competitors are capturing disproportionate share of net-new mid-market business formation.

4. The AI TAM Threat



Slow-burn risk. If GenAI automates 30% of HR tasks, clients require fewer HR seats, potentially structurally reducing PEPM (Per Employee Per Month) revenue over the next 5 years.

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ADP Lyric HCM Platform

Persona-Based AI Agents

(Launched Jan 2026 for HR, Payroll, Employees).
5M+ GenAI conversations processed.

Enterprise Workforce Management

Powered by **$1.2B WorkForce Software** acquisition (Oct 2024).
Multi-country payroll in **75+** countries.

Cloud-Native Infrastructure

Built on AWS, **~250** microservices, graph/SQL databases.

Strategic Objective

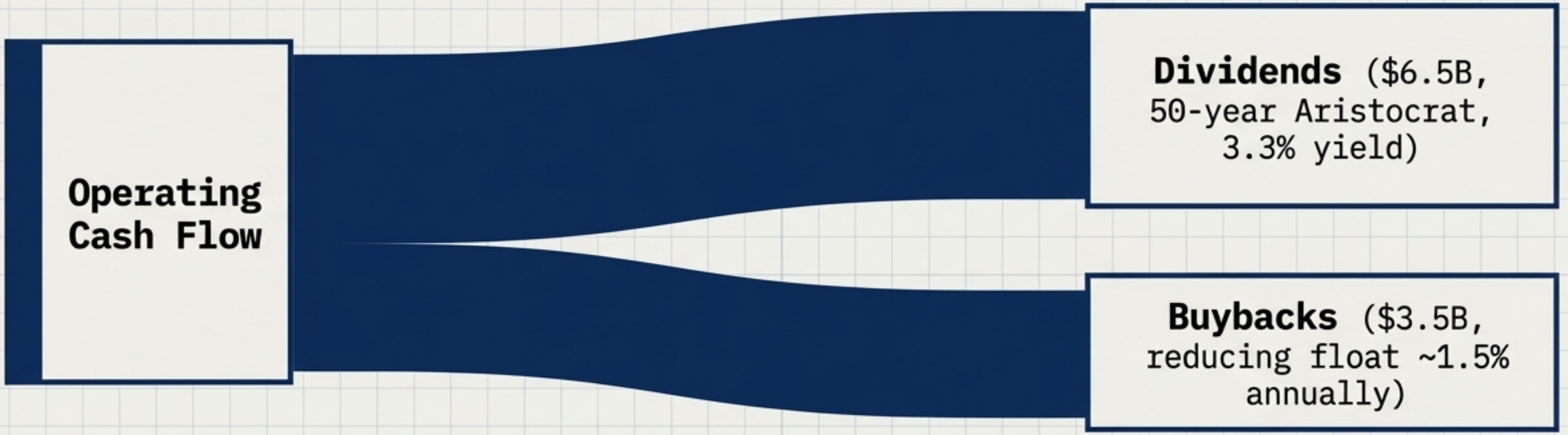
The Execution Mandate:

Lyric is ADP's ground-up response to Workday and SAP. Success here is required to re-enter the Gartner MQ, defend the enterprise base, and reaccelerate bookings to the 5-7% target.

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Financial Stewardship & Capital Allocation Framework

$10 Billion Returned Over 3 Years



Balance Sheet (Excellent)

Zero net corporate debt.

0.5x Net Debt/EBITDA.

AA- Rating.

R&D Intensity (Caution)

R&D is $1.39B, but only 6.8% of revenue (vs. Paycom at ~15%).

ADP must do more with less relative to its revenue base.

Buyback Discipline (Mixed)

Historically bought back stock at a premium 29x P/E. Current repurchases at ~20x P/E are arguably value-accretive for the first time in years.

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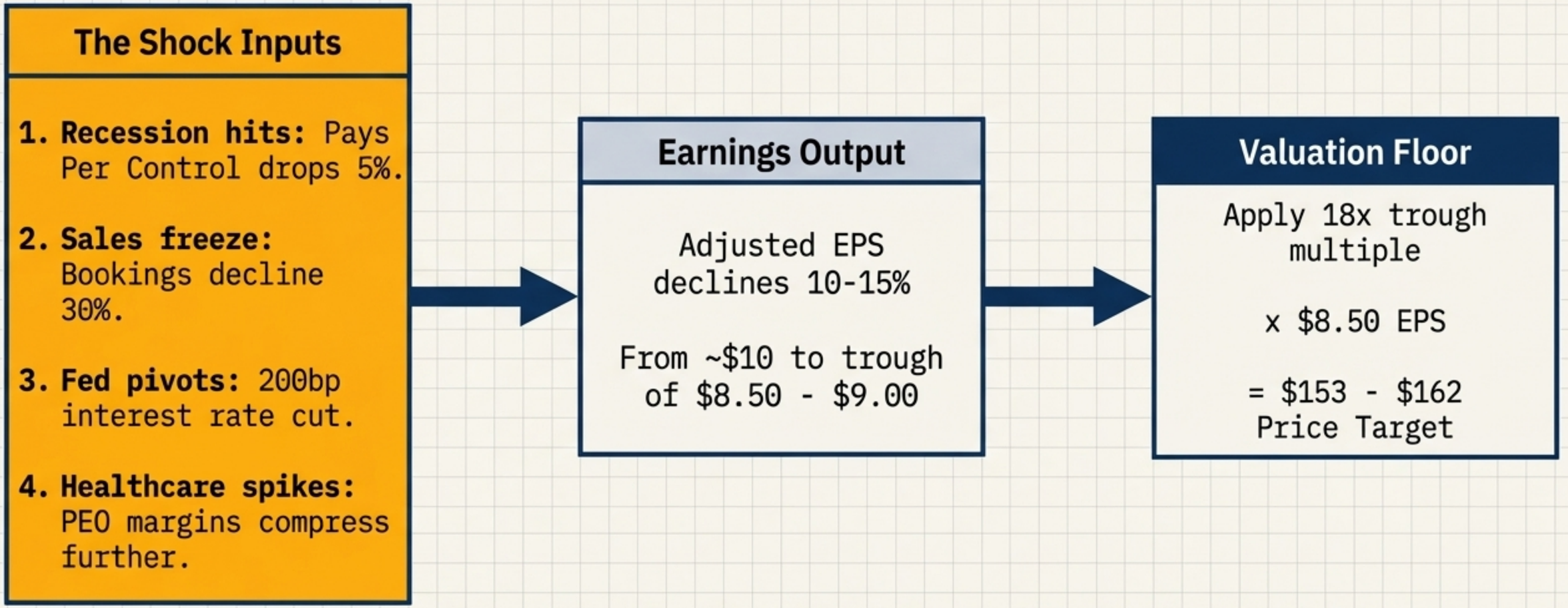
Profit Drivers Matrix: Exogenous vs. Endogenous Factors

	Headwind (Pressuring Growth)	**Tailwind** (Driving Growth)
External (Macro)	**The Macro Reality** Cooling labor market (+1% PPC), Structural healthcare inflation crushing PEO margins.	**The Illusion of Growth** Float Income surging to $1.2B due to Fed rate hikes.
Internal (Management)	**The Legacy Drag** Mid-market share loss to single-database competitors (Paycom/Paylocity); 3% bookings drop.	**The Path Forward** Lyric HCM execution, AI Assist deployment, PEPM expansion.

Insight: ADP's recent profit surge was dangerously Exogenous (Rates). Its future survival and growth rely entirely on Endogenous execution (Lyric HCM).

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Stress Test Diagnostic Panel: Catastrophe Case Analysis



Conclusion: The Catastrophe Case represents roughly 20-25% downside. A genuine, but capped, bear case for a business that has never experienced a sustained earnings decline in 75 years.

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The Valuation Floor



A reverse DCF implies the market **is pricing in a perpetual growth rate of just 4.8% — drastically below ADP's actual 9-10% EPS growth**. Even a below-average 25x multiple on FY26 EPS (~$11) yields a **$275 valuation (35% upside)**.

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THE DUALITY

The Moat

50%+ ROIC

92% retention

50 years of dividend increases. Impossible to replicate.

The Vulnerability

22% of EBIT tied to interest rates

3% bookings growth

legacy tech debt in the enterprise segment.

THE VERDICT

Durable, but not invincible.

ADP is trading at a valuation that assumes structural deceleration. If Lyric HCM successfully repositions ADP as a **modern, AI-native enterprise platform, it reignites the bookings engine.**

At ~20x earnings, the asymmetry of outcomes heavily favors investors willing to underwrite the execution risk of this multi-year technology transition.

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