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Rocer Hagadone

Other People's Money

As Corporate America's paycheck-processing king, ADP has a lot of spare cash on hand.

AN INTERVIEW WITH

JAN SIEGMUND

CVP and CFO, Automatic Data Processing

Automatic Data Processing, the provider of seemingly ubiquitous human-resources systems and services, processes paychecks for about one in six American workers. At any moment the company is holding \$20 billion to \$25 billion worth of its customers' payroll funds before disbursing them to the customers' employees. Even in this age of ultralow interest rates, the company manages to generate a fairly healthy return on investing customer cash, says Jan Siegmund, who took over as CFO in November.

ADP generally has on its balance sheet about \$1.5 billion of its own cash, which it uses to pay dividends and make an average of about eight acquisitions per year. (Shareholders have received a payout from ADP for 38 straight years.) Free cash flow is especially strong these days, according to Siegmund. It's why ADP is one of only four U.S. com-

panies to have a triple-A credit rating from both Standard & Poor's and Moody's Investors Service (the others are Exxon Mobil, Johnson & Johnson, and Microsoft).

Historically, ADP mainly provided "core" HR technology for payroll processing, payroll tax compliance, and benefits administration. But over the past few years it has been acquiring its way toward competitiveness in the talent-management software space.

About two-thirds of the company's 600,000 or so clients have fewer than 50 employees. Most of the rest have up to a few thousand workers, but at the high end ADP has an offering called GlobalView that provides an integrated payroll and HR solution for the largest multinational companies.

Recently, Siegmund talked to CFO about ADP's strategies and the HR technology market.

At the end of your most recent fiscal year you were holding \$21.5 billion of your clients' cash. What do you do with it?

We have a sophisticated investment strategy that generates interest income, which is an important part of ADP's earnings. We're earning a 2.2% to 2.3% return. The strategy has several priorities. But number one, it's our clients' money, so we have only very safe investments that could be liquidated at any moment if we had to.

We also borrow against those investments. We have a hold-to-maturity and borrowing strategy that maximizes the overall yield. The 2.2% comes from investing longer and borrowing to balance out liquidity needs that may arise due to fluctuations in the fund balances.

And then we have similar business models, where, for example, if you use our 401(k) solution, we collect company contributions and hold them for the few days between the issuance of paychecks and when the money shows up in employees' accounts. We also have some workers' compensation offerings that work like that.

What are you doing with the \$1.5 billion of your own cash on your balance sheet?

Our business has very good free cash flow. That's a very important value proposition to our investors. It's a low-capital-intensive business, but we spend \$150 million to \$200 million a year on capital investments and maybe \$400 million on acquisitions. And we have a dividend yield between 2.5% and 3%. We also have a continuous share-buyback program. The outstanding shares of common stock have been reduced by about 10% over the last five years in order to offset dilution from employee stock-compensation programs and to increase earnings per share.

What has ADP been doing with regard to talent management?

We see talent management as having five major components: recruiting, performance management, succession planning, compensation management and learning. Those are all part of our talent-management suite.

We started with a recruiting solution about seven years ago. Five years ago we formed an alliance with Cornerstone on Demand to distribute its talent-management product. About three years ago we acquired a company called Workscape, which had a benefits-administration system and was also a market leader in compensation management, and we added three modules to make it our suite.

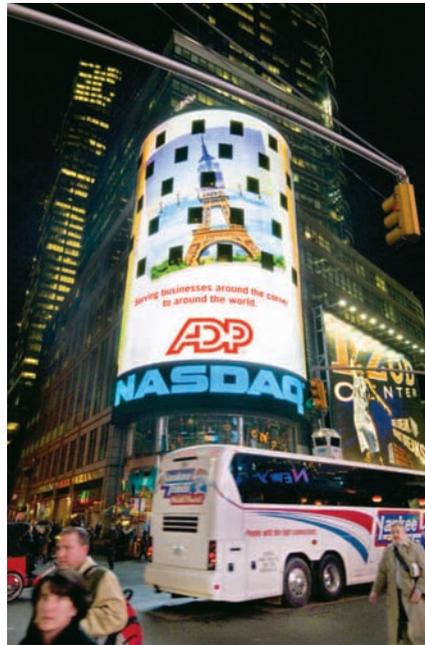
How did your payroll customers respond as you introduced your talent-management modules?

Clients today more often than not want to buy products that are available as an integrated suite. That's been the driver of our strategy, to transform ourselves from a more silo type of company with best-of-breed applications to the suite concept.

You've been trying to catch up in talent management, but according to your most recent annual report your research-and-development spend was only about 6% of revenue. Some software companies are spending three times that much on R&D. How do you arrive at an appropriate level of development?

Well, as CFO I face a lot of demands for spending money, and our R&D folks are not short on new ideas!

ADP has always stood for service with our payroll solutions and strength in regulatory compliance. Our new CEO, Carlos Rodriguez, who came on board a year and a half ago, has really made it a point to emphasize that we also care about innovation and technologi-



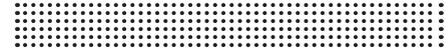
cal competence. So we have made a lot of investment in developing better product faster.

But we have done so while keeping the ratio of R&D to revenue roughly in the same area. We didn't even take it down during the economic downturn. Now we are focusing on reducing the complexity of our product portfolio, which grew out of all the acquisitions we have done. So we have fewer products but are increasing the R&D dollars available for them.

When you see 6% [spent on] R&D, it's a little misleading. We are investing far, far more than that on our talent-management suite. But in payroll, in absolute-dollar terms we already invest four times what our nearest competitor does, so we don't have to think about having a certain percentage of revenue in the product.

What are your observations about the HR technology product market? There have been a lot of changes in the past couple of years.

Yes, it's a dynamic market space, with SAP acquiring Success Factors, Oracle



buying Taleo as a consequence and Cornerstone going stronger to market. Workday is being very active in the large-company ERP market. So ADP is playing in a very attractive market, and it's a market where we've obviously shown that you can make good margins.

People ask me whether we face increased competition and how it's changing our world. And my answer is, we always have faced competition. Fifteen and 20 years ago it was PeopleSoft that was transforming the upper end of the market, and today there's a lot of talk about Workday and Ultimate. So we've always had a slew of competi-

tors and have always had to be on our toes. I take it as a good challenge for us.

How does the business that ADP is in, HR automation, influence what you as a CFO do day to day?

Everything I do aims to drive the growth of our business and make sure we are executing against our strategic growth initiatives. I was the chief strategy officer prior to this role and for many years I ran one of our businesses. So I don't come with a financial background. I'm a PhD economist, but I don't have a CPA-type background.

Well, you're the CFO. You're responsible for the accuracy of the financials, and you've got to sign off on them.

Where do you get the confidence that the financials are on the money?

Financial management and financial controls are a bedrock of ADP. We're in the payroll business, and we do accounting stuff for clients. So it's in our culture to have a very strong finance team. I do spend a good deal of time reviewing and overseeing the process.

► INTERVIEW BY DAVID McCANN

ON THE COMPETITION:
"People ask me whether we face increased competition. Fifteen years ago it was PeopleSoft...and today there's a lot of talk about Workday and Ultimate. So we've always had a slew of competitors and have always had to be on our toes."

Health Care Reform's
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