

AUTOMATIC DATA PROCESSING INC

Form 10-Q

May 06, 2011

---

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 March 31, 2011

OR

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

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-5397

\_\_\_\_\_  
AUTOMATIC DATA PROCESSING, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

22-1467904  
(IRS Employer Identification No.)

One ADP Boulevard, Roseland, New Jersey  
(Address of principal executive offices)

07068  
(Zip Code)

\_\_\_\_\_  
Registrant's telephone number, including area code: (973) 974-5000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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 April 29, 2011 was 499,704,802.

---

## 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<br>March 31, |                | Nine Months Ended<br>March 31, |                  |
|--|---------------------------------|----------------|--------------------------------|------------------|
|  | 2011                            | 2010           | 2011                           | 2010             |
| <b>REVENUES:</b>   |                                 |                |                                |                  |
| Revenues, other than interest on funds held for clients and PEO revenues   | \$2,143.5                       | \$1,919.3      | \$5,828.2                      | \$5,355.1        |
| Interest on funds held for clients   | 148.6                           | 147.9          | 404.4                          | 403.5            |
| PEO revenues (A)   | 445.2                           | 376.0          | 1,139.8                        | 978.8            |
| <b>TOTAL REVENUES</b>  | <b>2,737.3</b>                  | <b>2,443.2</b> | <b>7,372.4</b>                 | <b>6,737.4</b>   |
| <b>EXPENSES:</b>   |                                 |                |                                |                  |
| <b>Costs of revenues:</b>  |                                 |                |                                |                  |
| Operating expenses   | 1,300.3                         | 1,140.3        | 3,590.5                        | 3,190.6          |
| Systems development and programming costs  | 155.8                           | 130.0          | 432.9                          | 376.2            |
| Depreciation and amortization  | 64.5                            | 60.4           | 189.4                          | 180.6            |
| <b>TOTAL COSTS OF REVENUES</b>   | <b>1,520.6</b>                  | <b>1,330.7</b> | <b>4,212.8</b>                 | <b>3,747.4</b>   |
| Selling, general and administrative expenses   | 577.3                           | 504.9          | 1,663.0                        | 1,515.5          |
| Interest expense   | 1.4                             | 1.2            | 6.9                            | 6.8              |
| <b>TOTAL EXPENSES</b>  | <b>2,099.3</b>                  | <b>1,836.8</b> | <b>5,882.7</b>                 | <b>5,269.7</b>   |
| Other income, net  | (15.0 )                         | (26.6 )        | (84.3 )                        | (90.0 )          |
| <b>EARNINGS FROM CONTINUING OPERATIONS</b>   |                                 |                |                                |                  |
| <b>BEFORE INCOME TAXES</b>   | <b>653.0</b>                    | <b>633.0</b>   | <b>1,574.0</b>                 | <b>1,557.7</b>   |
| Provision for income taxes   | 229.2                           | 231.4          | 561.6                          | 558.0            |
| <b>NET EARNINGS FROM CONTINUING OPERATIONS</b>   | <b>\$423.8</b>                  | <b>\$401.6</b> | <b>\$1,012.4</b>               | <b>\$999.7</b>   |
| Earnings from discontinued operations, net of provision for income taxes of \$6.1 for the three months ended March 31, 2010 and \$7.0 for the nine months ended March 31, 2010, respectively |                                 |                |                                |                  |
|  | -                               | 2.0            | -                              | 3.8              |
| <b>NET EARNINGS</b>  | <b>\$423.8</b>                  | <b>\$403.6</b> | <b>\$1,012.4</b>               | <b>\$1,003.5</b> |
| Basic Earnings Per Share from Continuing Operations  | \$0.85                          | \$0.80         | \$2.05                         | \$1.99           |
| Basic Earnings Per Share from Discontinued Operations  | -                               | -              | -                              | 0.01             |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|   |               |               |               |               |
|---|---------------|---------------|---------------|---------------|
| <b>BASIC EARNINGS PER SHARE</b>                         | <b>\$0.85</b> | <b>\$0.80</b> | <b>\$2.05</b> | <b>\$2.00</b> |
| Diluted Earnings Per Share from Continuing Operations   | \$0.85        | \$0.79        | \$2.03        | \$1.98        |
| Diluted Earnings Per Share from Discontinued Operations | -             | -             | -             | 0.01          |
| <b>DILUTED EARNINGS PER SHARE</b>                       | <b>\$0.85</b> | <b>\$0.80</b> | <b>\$2.03</b> | <b>\$1.99</b> |
| Basic weighted average shares outstanding               | 496.2         | 502.4         | 493.2         | 501.9         |
| Diluted weighted average shares outstanding             | 501.3         | 505.5         | 497.5         | 504.8         |
| Dividends declared per common share                     | \$0.3600      | \$0.3400      | \$1.0600      | \$1.0100      |

(A) Professional Employer Organization (“PEO”) revenues are net of direct pass-through costs, primarily consisting of payroll wages and payroll taxes, of \$4,177.9 and \$3,478.6 for the three months ended March 31, 2011 and 2010, respectively, and \$11,760.6 and \$10,094.1 for the nine months ended March 31, 2011 and 2010, respectively.

See notes to the consolidated financial statements.

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

|   | March 31,<br>2011 | June 30,<br>2010 |
|---|-------------------|------------------|
| Assets  |                   |                  |
| Current assets:   |                   |                  |
| Cash and cash equivalents                                 | \$1,600.9         | \$1,643.3        |
| Short-term marketable securities                          | 43.6              | 27.9             |
| Accounts receivable, net                                  | 1,293.8           | 1,127.7          |
| Other current assets                                      | 680.8             | 673.4            |
| Assets held for sale                                      | 12.3              | 11.8             |
| Total current assets before funds held for clients        | 3,631.4           | 3,484.1          |
| Funds held for clients                                    | 32,451.9          | 18,832.6         |
| Total current assets                                      | 36,083.3          | 22,316.7         |
| Long-term marketable securities                           | 96.6              | 104.3            |
| Long-term receivables, net                                | 125.3             | 129.4            |
| Property, plant and equipment, net                        | 685.4             | 673.8            |
| Other assets  | 815.1             | 712.3            |
| Goodwill  | 3,072.0           | 2,383.3          |
| Intangible assets, net                                    | 718.7             | 542.4            |
| Total assets  | \$41,596.4        | \$26,862.2       |
| Liabilities and Stockholders' Equity                      |                   |                  |
| Current liabilities:                                      |                   |                  |
| Accounts payable  | \$131.8           | \$150.0          |
| Accrued expenses and other current liabilities            | 700.5             | 771.0            |
| Accrued payroll and payroll-related expenses              | 531.6             | 448.5            |
| Dividends payable   | 176.1             | 164.5            |
| Short-term deferred revenues                              | 378.6             | 321.5            |
| Income taxes payable                                      | 40.1              | 60.0             |
| Total current liabilities before client funds obligations | 1,958.7           | 1,915.5          |
| Client funds obligations                                  | 32,015.4          | 18,136.7         |
| Total current liabilities                                 | 33,974.1          | 20,052.2         |
| Long-term debt  | 34.6              | 39.8             |
| Other liabilities   | 551.6             | 528.0            |
| Deferred income taxes                                     | 381.7             | 306.4            |
| Long-term deferred revenues                               | 459.9             | 456.9            |
| Total liabilities   | 35,401.9          | 21,383.3         |
| 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 March 31, 2011 and June 30, 2010;               |                   |                  |
| outstanding, 498.2 and 492.0 shares at March 31, 2011     |                   |                  |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|   |            |            |
|---|------------|------------|
| and June 30, 2010, respectively                   | 63.9       | 63.9       |
| Capital in excess of par value                    | 479.3      | 493.0      |
| Retained earnings                                 | 11,739.5   | 11,252.0   |
| Treasury stock - at cost: 140.5 and 146.7 shares  |            |            |
| at March 31, 2011 and June 30, 2010, respectively | (6,287.1 ) | (6,539.5 ) |
| Accumulated other comprehensive income            | 198.9      | 209.5      |
| Total stockholders' equity                        | 6,194.5    | 5,478.9    |
| Total liabilities and stockholders' equity        | \$41,596.4 | \$26,862.2 |

See notes to the consolidated financial statements.

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

|   | Nine Months Ended<br>March 31, |             |
|---|--------------------------------|-------------|
|   | 2011                           | 2010        |
| <b>Cash Flows from Operating Activities:</b>  |                                |             |
| Net earnings  | \$1,012.4                      | \$1,003.5   |
| Adjustments to reconcile net earnings to cash flows provided by operating activities:                         |                                |             |
| Depreciation and amortization   | 239.2                          | 232.8       |
| Deferred income taxes   | 51.8                           | 50.8        |
| Stock-based compensation expense  | 58.5                           | 55.0        |
| Net pension expense   | 30.3                           | 26.0        |
| Net realized (gain)/loss from the sales of marketable securities  | (19.7 )                        | 1.3         |
| Net amortization of premiums and accretion of discounts on available-for-sale securities                      | 40.8                           | 43.6        |
| Impairment losses on available-for-sale securities  | -                              | 5.3         |
| Impairment losses on assets held for sale   | 8.6                            | -           |
| Gains on sales of buildings   | (1.8 )                         | (1.5 )      |
| Gain on sale of discontinued businesses, net of tax   | -                              | (0.2 )      |
| Other   | 32.5                           | 9.7         |
| Changes in operating assets and liabilities, net of effects from acquisitions and divestitures of businesses: |                                |             |
| Increase in accounts receivable   | (71.0 )                        | (91.6 )     |
| (Increase)/Decrease in other assets   | (91.9 )                        | 155.1       |
| Decrease in accounts payable  | (42.8 )                        | (19.5 )     |
| Decrease in accrued expenses and other liabilities  | (26.6 )                        | (183.6 )    |
| Operating activities of discontinued operations   | -                              | (0.1 )      |
| Net cash flows provided by operating activities   | 1,220.3                        | 1,286.6     |
| <b>Cash Flows from Investing Activities:</b>  |                                |             |
| Purchases of corporate and client funds marketable securities   | (3,621.3 )                     | (2,685.3 )  |
| Proceeds from the sales and maturities of corporate and client funds marketable securities                    | 2,315.9                        | 2,592.9     |
| Net increase in restricted cash and cash equivalents held to satisfy client funds obligations                 | (12,392.2 )                    | (9,757.5 )  |
| Capital expenditures  | (122.1 )                       | (76.5 )     |
| Additions to intangibles  | (58.9 )                        | (87.5 )     |
| Acquisitions of businesses, net of cash acquired  | (774.7 )                       | (98.9 )     |
| Proceeds from the sale of property, plant and equipment   | 13.1                           | 3.1         |
| Other   | 5.4                            | 6.9         |
| Investing activities of discontinued operations   | -                              | (0.1 )      |
| Proceeds from the sale of businesses included in discontinued operations                                      | -                              | 21.6        |
| Net cash flows used in investing activities   | (14,634.8 )                    | (10,081.3 ) |
| <b>Cash Flows from Financing Activities:</b>  |                                |             |
| Net increase in client funds obligations  | 13,683.6                       | 9,799.7     |



Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|  |           |           |
|--|-----------|-----------|
| Payments of debt   | (5.3 )    | (1.3 )    |
| Net repayment of commercial paper                                | -         | (730.0 )  |
| Repurchases of common stock                                      | (174.8 )  | (279.2 )  |
| Proceeds from stock purchase plan and exercises of stock options | 345.5     | 201.3     |
| Dividends paid   | (513.2 )  | (498.1 )  |
| Net cash flows provided by financing activities                  | 13,335.8  | 8,492.4   |
| Effect of exchange rate changes on cash and cash equivalents     | 36.3      | 2.0       |
| Net change in cash and cash equivalents                          | (42.4 )   | (300.3 )  |
| Cash and cash equivalents, beginning of period                   | 1,643.3   | 2,265.3   |
| Cash and cash equivalents, end of period                         | \$1,600.9 | \$1,965.0 |

See notes to the consolidated financial statements.

Automatic Data Processing, Inc. and Subsidiaries  
Notes to the Consolidated Financial Statements  
(Tabular dollars in millions, except per share amounts)  
(Unaudited)

Note 1. Basis of Presentation

The accompanying Consolidated Financial Statements and footnotes thereto of Automatic Data Processing, Inc. and its subsidiaries (“ADP” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“US 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 statement of the Company’s results for the interim periods.

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenue, costs, expenses and accumulated other comprehensive income that are reported in the Consolidated Financial Statements and footnotes thereto. Actual results may differ from those estimates.

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 twelve months ended June 30, 2010 (“fiscal 2010”).

Note 2. New Accounting Pronouncements

On July 1, 2010, the Company adopted the Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) 2009-13, “Multiple Deliverable Revenue Arrangements,” and ASU 2009-14, “Certain Revenue Arrangements that Include Software Elements.” ASU 2009-13 modifies the guidance related to accounting for arrangements with multiple deliverables by providing an alternative when vendor specific objective evidence (“VSOE”) or third-party evidence (“TPE”) does not exist to determine the selling price of a deliverable. The alternative when VSOE or TPE does not exist is management’s best estimate of the selling price of the deliverable. Consideration for multiple deliverables is then allocated based upon the relative selling price of the deliverables and revenue is recognized as earned for each deliverable. ASU 2009-14 modifies the scope of the software revenue recognition guidance to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product’s functionality. The adoption of ASU 2009-13 and ASU 2009-14 did not have a material impact on the Company’s consolidated results of operations, financial condition or cash flows.

In December 2010, the Company adopted ASU 2010-20, “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” ASU 2010-20 requires greater transparency about a company’s allowance for credit losses and the credit quality of its financing receivables. The guidance is intended to provide disclosures to help facilitate the evaluation of the Company’s credit risk, how that risk is analyzed and the reasons for changes in the allowance for credit losses. The adoption of ASU 2010-20 did not have an impact on the Company’s consolidated results of operations, financial condition or cash flows.

In December 2010, the FASB issued ASU 2010-29, “Disclosure of Supplementary Pro Forma Information for Business Combinations.” ASU 2010-29 requires an entity to disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

comparable prior annual reporting period. ASU 2010-29 is effective prospectively for business combinations that occur on or after the beginning of the first annual reporting period beginning after December 15, 2010. The Company does not expect that the adoption of ASU 2010-29 will have an impact on its consolidated results of operations, financial condition or cash flows.

Note 3. Earnings per Share (“EPS”)

|   | Basic     | Effect of<br>Employee<br>Stock<br>Option<br>Shares | Effect of<br>Employee<br>Restricted<br>Stock<br>Shares | Diluted   |
|---|-----------|--|--|-----------|
| Three months ended March 31,            |           |  |  |           |
| 2011                                    |           |  |  |           |
| Net earnings from continuing operations | \$423.8   | \$-  | \$-  | \$423.8   |
| Weighted average shares (in millions)   | 496.2     | 4.5  | 0.6  | 501.3     |
| EPS from continuing operations          | \$0.85    |  |  | \$0.85    |
| 2010                                    |           |  |  |           |
| Net earnings from continuing operations | \$401.6   | \$-  | \$-  | \$401.6   |
| Weighted average shares (in millions)   | 502.4     | 2.8  | 0.3  | 505.5     |
| EPS from continuing operations          | \$0.80    |  |  | \$0.79    |
| Nine months ended March 31,             |           |  |  |           |
| 2011                                    |           |  |  |           |
| Net earnings from continuing operations | \$1,012.4 | \$-  | \$-  | \$1,012.4 |
| Weighted average shares (in millions)   | 493.2     | 3.2  | 1.1  | 497.5     |
| EPS from continuing operations          | \$2.05    |  |  | \$2.03    |
| 2010                                    |           |  |  |           |
| Net earnings from continuing operations | \$999.7   | \$-  | \$-  | \$999.7   |
| Weighted average shares (in millions)   | 501.9     | 1.8  | 1.1  | 504.8     |
| EPS from continuing operations          | \$1.99    |  |  | \$1.98    |

Options to purchase 0.7 million and 12.8 million shares of common stock for the three months ended March 31, 2011 and 2010, respectively, and 2.8 million and 19.3 million shares of common stock for the nine months ended March 31, 2011 and 2010, respectively, were excluded from the calculation of diluted earnings per share because their exercise prices exceeded the average market price of outstanding common shares for the respective periods.

Note 4. Other Income, net

|   | Three Months Ended<br>March 31, |           | Nine Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|--------------------------------|-----------|
|   | 2011                            | 2010      | 2011                           | 2010      |
| Interest income on corporate funds              | \$(10.0 )                       | \$(10.6 ) | \$(68.8 )                      | \$(78.2 ) |
| Realized gains on available-for-sale securities | (5.4 )                          | (1.5 )    | (23.0 )                        | (11.7 )   |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Realized losses on available-for-sale securities   | 1.0       | 0.9       | 3.3       | 13.0      |
| Realized gain on investment in the Reserve Fund    | -         | (14.8 )   | (0.9 )    | (15.2 )   |
| Impairment losses on available-for-sale securities | -         | -         | -         | 5.3       |
| Impairment losses on assets held for sale          | -         | -         | 8.6       | -         |
| Gains on sales of buildings                        | -         | -         | (1.8 )    | (1.5 )    |
| Other, net   | (0.6 )    | (0.6 )    | (1.7 )    | (1.7 )    |
| Other income, net                                  | \$(15.0 ) | \$(26.6 ) | \$(84.3 ) | \$(90.0 ) |

Proceeds from sales and maturities of available-for-sale securities were \$2,315.9 million and \$2,592.9 million for the nine months ended March 31, 2011 and 2010, respectively.

During the nine months ended March 31, 2011, the Company recorded a gain of \$0.9 million to other income, net on the Statements of Consolidated Earnings related to the Primary Fund of the Reserve Fund (the "Reserve Fund"). During the three and nine months ended March 31, 2010, the Company recorded gains of \$14.8 million and \$15.2 million, respectively, to other income, net on the Statements of Consolidated Earnings related to the Reserve Fund.

At September 30, 2010, the Company reclassified assets related to two buildings as assets held for sale on the Consolidated Balance Sheets. Such assets were previously reported in property, plant and equipment, net on the Consolidated Balance Sheets. As the carrying amount of the assets held for sale exceeded their fair value less costs to sell, the Company recorded impairment losses of \$8.6 million for the nine months ended March 31, 2011. These two buildings continue to be recorded in assets held for sale at March 31, 2011.

During the nine months ended March 31, 2011, the Company sold two buildings and, as a result, recorded a gain of \$1.8 million. During the nine months ended March 31, 2010, the Company sold a building and recorded a gain of \$1.5 million.

At September 30, 2009, the Company concluded that it had the intent to sell certain securities for which unrealized losses of \$5.3 million were previously recorded in accumulated other comprehensive income on the Consolidated Balance Sheets. As such, the Company realized impairment losses of \$5.3 million during the nine months ended March 31, 2010. The Company subsequently sold all securities that the Company previously concluded it had the intent to sell.

The Company has an outsourcing agreement with Broadridge Financial Solutions, Inc. ("Broadridge") pursuant to which the Company provides data center outsourcing services, primarily consisting of information technology and service delivery network services. As a result of this agreement, the Company recognized income of \$27.7 million and \$26.2 million for the three months ended March 31, 2011 and 2010, respectively, which is offset by expenses directly associated with providing such services of \$27.1 million and \$25.6 million, respectively, both of which were recorded in other income, net, on the Statements of Consolidated Earnings. The Company recognized income of \$82.3 million and \$78.4 million for the nine months ended March 31, 2011 and 2010, respectively, which is offset by expenses directly associated with providing such services of \$80.6 million and \$76.7 million. The Company had a receivable on the Consolidated Balance Sheets from Broadridge for the services under this agreement of \$9.2 million and \$8.9 million as of March 31, 2011 and June 30, 2010, respectively. In fiscal 2010, Broadridge notified the Company that it would not extend the outsourcing agreement beyond its current expiration date of June 30, 2012. The Company does not currently anticipate this will have a material impact on its results of operations.

#### Note 5. Acquisitions

On August 16, 2010, the Company acquired 100% of the outstanding shares of Cobalt, a leading provider of digital marketing solutions for the automotive industry that aligns with Dealer Services' global layered applications strategy and strongly supports Dealer Services' long-term growth strategy, for approximately \$405.4 million in cash, net of

cash acquired.

The preliminary purchase price allocation for Cobalt is as follows:

|                                |         |
|--------------------------------|---------|
| Accounts receivable, net       | \$42.5  |
| Goodwill                       | 316.6   |
| Identifiable intangible assets | 111.6   |
| Other assets                   | 57.5    |
| Total assets acquired          | \$528.2 |
| <br>                           |         |
| Total liabilities acquired     | \$101.1 |

The preliminary allocation of the purchase price is based upon estimates and assumptions that are subject to change within the purchase price allocation period, which is generally one year from the acquisition date. The primary areas of the purchase price allocation that are not yet finalized relate to the measurement of certain assets and liabilities.

The Company determined the purchase price allocations for this acquisition based on estimates of the fair value of tangible and intangible assets acquired and liabilities assumed, utilizing recognized valuation techniques, including the income and market approaches. Goodwill for Cobalt, which is not deductible for tax purposes, resulted from the expected impact to Dealer Services' long-term growth strategy. Intangible assets for Cobalt, which totaled \$111.6 million, included customer contracts and lists, software and trademarks that are being amortized over a weighted average life of approximately 11 years.

In addition to Cobalt, the Company acquired seven businesses during the nine months ended March 31, 2011 for approximately \$369.3 million, net of cash acquired. These acquisitions resulted in approximately \$277.2 million of goodwill. Intangible assets acquired, which totaled approximately \$133.1 million for these seven acquisitions, included customer contracts and lists, software and trademarks that are being amortized over a weighted average life of approximately 9 years. These seven acquisitions were not material individually or in the aggregate to the Company's results of operations, financial position or cash flows.

#### Note 6. Divestitures

On March 24, 2010, the Company completed the sale of the non-core Commercial Systems business (the "Commercial business") for approximately \$21.6 million in cash. The Commercial business was previously reported in the Dealer Services segment. In connection with the disposal of this business, the Company has classified the results of this business as discontinued operations for all periods presented. During the three and nine months ended March 31, 2010, the Company reported a gain of \$5.6 million, or \$1.0 million after taxes, within earnings from discontinued operations on the Statements of Consolidated Earnings.

During the three and nine months ended March 31, 2010, the Company recorded charges of \$0.8 million related to a change in estimated taxes on the divestitures of businesses.

Operating results for discontinued operations were as follows:

|          | Three<br>Months<br>Ended<br>March 31,<br>2010 | Nine<br>Months<br>Ended<br>March 31,<br>2010 |
|----------|---|--|
| Revenues | \$4.2   | \$17.2                                       |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|  |       |       |
|--|-------|-------|
| Earnings from discontinued operations before income taxes  | 2.5   | 5.2   |
| Less: Provision for income taxes   | 0.7   | 1.6   |
| Net earnings from discontinued operations before gain on disposal of discontinued operations   | \$1.8 | \$3.6 |
| Gain on disposal of discontinued operations, net of provision for income taxes of \$5.4 for the three and nine months ended March 31, 2010 | \$0.2 | \$0.2 |
| Net earnings from discontinued operations  | \$2.0 | \$3.8 |

There were no assets or liabilities of discontinued operations as of March 31, 2011 or June 30, 2010.

Note 7. Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients at March 31, 2011 and June 30, 2010 were as follows:

| Type of issue:   | Amortized Cost | March 31, 2011         |                         | Fair Value |
|--|----------------|------------------------|-------------------------|------------|
|  |                | Gross Unrealized Gains | Gross Unrealized Losses |            |
| Money market securities and other cash equivalents     | \$17,522.7     | \$-                    | \$-                     | \$17,522.7 |
| Available-for-sale securities:                         |                |                        |                         |            |
| U.S. Treasury and direct obligations of                |                |                        |                         |            |
| U.S. government agencies                               | 6,519.0        | 188.0                  | (31.5 )                 | 6,675.5    |
| Corporate bonds  | 5,631.4        | 211.1                  | (31.7 )                 | 5,810.8    |
| Asset-backed securities                                | 564.7          | 27.5                   | -                       | 592.2      |
| Canadian government obligations and                    |                |                        |                         |            |
| Canadian government agency obligations                 | 1,059.6        | 20.4                   | (1.5 )                  | 1,078.5    |
| Other securities                                       | 2,429.1        | 95.8                   | (11.6 )                 | 2,513.3    |
| Total available-for-sale securities                    | 16,203.8       | 542.8                  | (76.3 )                 | 16,670.3   |
| Total corporate investments and funds held for clients | \$33,726.5     | \$542.8                | \$(76.3 )               | \$34,193.0 |

| Type of issue:                                     | Amortized Cost | June 30, 2010          |                         | Fair Value |
|--|----------------|------------------------|-------------------------|------------|
|  |                | Gross Unrealized Gains | Gross Unrealized Losses |            |
| Money market securities and other cash equivalents | \$5,091.1      | \$-                    | \$-                     | \$5,091.1  |
| Available-for-sale securities:                     |                |                        |                         |            |
| U.S. Treasury and direct obligations of            |                |                        |                         |            |
| U.S. government agencies                           | 5,631.0        | 280.7                  | (0.2 )                  | 5,911.5    |
| Corporate bonds                                    | 5,080.7        | 261.2                  | (9.0 )                  | 5,332.9    |
| Asset-backed securities                            | 923.5          | 45.3                   | -                       | 968.8      |
| Canadian government obligations and                |                |                        |                         |            |
| Canadian government agency obligations             | 998.6          | 33.9                   | -                       | 1,032.5    |
| Other securities                                   | 2,172.3        | 100.0                  | (1.0 )                  | 2,271.3    |

|  |            |         |           |            |
|--|------------|---------|-----------|------------|
| Total available-for-sale securities                    | 14,806.1   | 721.1   | (10.2 )   | 15,517.0   |
| Total corporate investments and funds held for clients | \$19,897.2 | \$721.1 | \$(10.2 ) | \$20,608.1 |

At March 31, 2011, U.S. Treasury and direct obligations of U.S. government agencies primarily include debt directly issued by Federal Home Loan Banks, Federal Home Loan Mortgage Corporation ("Freddie Mac") and Federal National Mortgage Association ("Fannie Mae") with fair values of \$3,595.9 million, \$880.4 million and \$831.9 million, respectively. At June 30, 2010, U.S. Treasury and direct obligations of U.S. government agencies primarily include debt directly issued by Federal Home Loan Banks, Freddie Mac and Fannie Mae with fair values of \$2,615.5 million, \$1,136.1 million and \$933.6 million, respectively. U.S. Treasury and direct obligations of U.S. government agencies represent senior, unsecured, non-callable debt that carries a credit rating of primarily AAA, as rated by Moody's and Standard & Poor's and has maturities ranging from April 2011 through February 2021.

At March 31, 2011, asset-backed securities primarily include AAA rated senior tranches of securities with predominately prime collateral of fixed rate credit card, rate reduction and auto loan receivables with fair values of \$333.9 million, \$212.3 million and \$45.5 million, respectively. At June 30, 2010, asset-backed securities include AAA rated senior tranches of securities with predominately prime collateral of fixed rate credit card, rate reduction and auto loan receivables with fair values of \$548.6 million, \$307.8 million and \$112.4 million, respectively. These securities are collateralized by the cash flows of the underlying pools of receivables. The primary risk associated with these securities is the collection risk of the underlying receivables. All collateral on such asset-backed securities has performed as expected through March 31, 2011.

At March 31, 2011, other securities and their fair value primarily represent AAA rated commercial mortgage-backed securities of \$549.0 million, municipal bonds of \$503.0 million, Canadian provincial bonds of \$430.9 million, supranational bonds of \$374.5 million, sovereign bonds of \$350.0 million, AAA rated mortgage-backed securities of \$146.2 million that are guaranteed by Fannie Mae and Freddie Mac and corporate bonds backed by the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program of \$129.8 million. At June 30, 2010, other securities and their fair value primarily represent AAA rated commercial mortgage-backed securities of \$707.4 million, municipal bonds of \$469.5 million, supranational bonds of \$322.7 million, Canadian provincial bonds of \$308.5 million, sovereign bonds of \$181.8 million, corporate bonds backed by the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program of \$131.3 million and AAA rated mortgage-backed securities of \$131.0 million that are guaranteed by Fannie Mae and Freddie Mac. The Company's AAA rated mortgage-backed securities represent an undivided beneficial ownership interest in a group or pool of one or more residential mortgages. These securities are collateralized by the cash flows of 15-year and 30-year residential mortgages and are guaranteed by Fannie Mae and Freddie Mac as to the timely payment of principal and interest.

Classification of corporate investments on the Consolidated Balance Sheets is as follows:

|                                  | March 31,<br>2011 | June 30,<br>2010 |
|----------------------------------|-------------------|------------------|
| Corporate investments:           |                   |                  |
| Cash and cash equivalents        | \$1,600.9         | \$1,643.3        |
| Short-term marketable securities | 43.6              | 27.9             |
| Long-term marketable securities  | 96.6              | 104.3            |
| Total corporate investments      | \$1,741.1         | \$1,775.5        |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

Funds held for clients represent assets whose underlying investments, based upon the Company's intent, are restricted for use solely for the purposes of satisfying the obligations to remit funds relating to our payroll and payroll tax filing services, which are classified as client funds obligations on our Consolidated Balance Sheets.

Funds held for clients have been invested in the following categories:

|  | March 31,<br>2011 | June 30,<br>2010 |
|--|-------------------|------------------|
| Funds held for clients:                          |                   |                  |
| Restricted cash and cash equivalents held        |                   |                  |
| to satisfy client funds obligations              | \$15,921.8        | \$3,447.8        |
| Restricted short-term marketable securities held |                   |                  |
| to satisfy client funds obligations              | 3,023.1           | 2,768.7          |
| Restricted long-term marketable securities held  |                   |                  |
| to satisfy client funds obligations              | 13,507.0          | 12,616.1         |
| Total funds held for clients                     | \$32,451.9        | \$18,832.6       |

Client funds obligations represent the Company's contractual obligations to remit funds to satisfy clients' payroll and tax payment obligations and are recorded on the Consolidated Balance Sheets at the time that the Company impounds funds from clients. The client funds obligations represent liabilities that will be repaid within one year of the balance sheet date. The Company has reported client funds obligations as a current liability on the Consolidated Balance Sheets totaling \$32,015.4 million and \$18,136.7 million as of March 31, 2011 and June 30, 2010, respectively. The Company has classified funds held for clients as a current asset since these funds are held solely for the purposes of satisfying the client funds obligations. The Company has reported the cash flows related to the purchases of corporate and client funds marketable securities and those related to the proceeds from the sales and maturities of corporate and client funds marketable securities on a gross basis in the investing section of the Statements of Consolidated Cash Flows. The Company has reported the cash inflows and outflows related to client funds investments with original maturities of 90 days or less on a net basis within net increase in restricted cash and cash equivalents and other restricted assets held to satisfy client funds obligations in the investing section of the Statements of Consolidated Cash Flows. The Company has reported the cash flows related to the cash received from and paid on behalf of clients on a net basis within net increase in client funds obligations in the financing section of the Statements of Consolidated Cash Flows.

Approximately 87% and 85% of the available-for-sale securities were rated AAA or AA at March 31, 2011 and June 30, 2010, respectively, as rated by Moody's, Standard & Poor's and, for Canadian securities, Dominion Bond Rating Service. All available-for-sale securities were rated as investment grade at March 31, 2011 and June 30, 2010.

Available-for-sale securities as of March 31, 2011 that have been in an unrealized loss position, all for periods of less than 12 months, are as follows:

|   | Unrealized<br>losses | Fair market<br>value |
|---|----------------------|----------------------|
| U.S. Treasury and direct obligations of |                      |                      |
| U.S. government agencies                | \$(31.5 )            | \$1,177.0            |
| Corporate bonds                         | (31.7 )              | 1,156.2              |
| Canadian government obligations and     |                      |                      |
| Canadian government agency obligations  | (1.5 )               | 68.4                 |



Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|                         |           |           |
|-------------------------|-----------|-----------|
| Asset backed securities | -         | 5.3       |
| Other securities        | (11.6 )   | 494.3     |
|                         | \$(76.3 ) | \$2,901.2 |

The unrealized losses and fair values of available-for-sale securities that have been in an unrealized loss position for a period of less than and greater than 12 months as of June 30, 2010 are as follows:

|   | Unrealized losses less than 12 months | Fair market value less than 12 months | Unrealized losses greater than 12 months | Fair market value greater than 12 months | Total gross unrealized losses | Total fair market value |
|---|---------------------------------------|---------------------------------------|--|--|-------------------------------|-------------------------|
| U.S. Treasury and direct obligations of |                                       |                                       |  |  |                               |                         |
| U.S. government agencies                | \$-                                   | \$28.0                                | \$(0.2 )                                 | \$6.5                                    | \$(0.2 )                      | \$34.5                  |
| Corporate bonds                         | (9.0 )                                | 210.5                                 | -  | -  | (9.0 )                        | 210.5                   |
| Asset backed securities                 | -                                     | 2.4                                   | -  | -  | -                             | 2.4                     |
| Other securities                        | (1.0 )                                | 22.7                                  | -  | -  | (1.0 )                        | 22.7                    |
|   | \$(10.0 )                             | \$263.6                               | \$(0.2 )                                 | \$6.5                                    | \$(10.2 )                     | \$270.1                 |

Expected maturities of available-for-sale securities at March 31, 2011 are as follows:

|  |                   |
|--|-------------------|
| Due in one year or less                    | \$3,066.7         |
| Due after one year to two years            | 3,390.2           |
| Due after two years to three years         | 1,946.5           |
| Due after three years to four years        | 2,815.6           |
| Due after four years                       | 5,451.3           |
| <b>Total available-for-sale securities</b> | <b>\$16,670.3</b> |

At March 31, 2011, the Company concluded that it did not have the intent to sell securities in an unrealized loss position as of March 31, 2011 and that the Company would not be required to sell such securities in an unrealized loss position before recovery. Additionally, the Company evaluated the securities in an unrealized loss position to determine the nature of the losses, utilizing a variety of quantitative and qualitative factors, including whether the Company expects to collect all amounts due under the contractual terms of the security, information about current and past events of the issuer, and the length of time and the extent to which the fair value has been less than the cost basis. At March 31, 2011, the Company concluded that unrealized losses on available-for-sale securities held at March 31, 2011 were not credit losses and were attributable to other factors, primarily changes in interest rates. As a result, the Company concluded that the \$76.3 million in unrealized losses on such securities should be recorded in accumulated other comprehensive income on the Consolidated Balance Sheets at March 31, 2011.

Note 8. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date and is based upon the Company's principal

or most advantageous market for a specific asset or liability.

US GAAP provides for a three-level hierarchy of inputs to valuation techniques used to measure fair value, defined as follows:

- Level 1 Fair value is determined based upon quoted prices for identical assets or liabilities that are traded in active markets.
- Level 2 Fair value is determined based upon inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability, including:
- quoted prices for similar assets or liabilities in active markets
  - quoted prices for identical or similar assets or liabilities in markets that are not active
  - inputs other than quoted prices that are observable for the asset or liability, or
  - inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3 Fair value is determined based upon inputs that are unobservable and reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability based upon the best information available in the circumstances (e.g., internally derived assumptions surrounding the timing and amount of expected cash flows).

Available-for-sale securities included in Level 1 are valued using closing prices for identical instruments that are traded on active exchanges. Available-for-sale securities included in Level 2 are valued utilizing inputs obtained from an independent pricing service. To determine the fair value of our Level 2 investments, a variety of inputs are utilized, including benchmark yields, reported trades, non-binding broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, new issue data, and monthly payment information. Over 99% of our Level 2 investments are valued utilizing inputs obtained from a pricing service. The Company reviews the values generated by the independent pricing service for reasonableness by comparing the valuations received from the independent pricing service to valuations from at least one other observable source. The Company has not adjusted the prices obtained from the independent pricing service. The Company has no available-for-sale securities included in Level 3.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the classification of assets and liabilities within the fair value hierarchy. In certain instances, the inputs used to measure fair value may meet the definition of more than one level of the fair value hierarchy. The significant input with the lowest level priority is used to determine the applicable level in the fair value hierarchy.

The following table presents the Company's assets measured at fair value on a recurring basis at March 31, 2011. Included in the table are available-for-sale securities within corporate investments of \$140.2 million and funds held for clients of \$16,530.1 million.

|  | Level 1 | Level 2   | Level 3 | Total     |
|--|---------|-----------|---------|-----------|
| U.S Treasury and direct obligations of |         |           |         |           |
| U.S. government agencies               | \$-     | \$6,675.5 | \$-     | \$6,675.5 |
| Corporate bonds                        | -       | 5,810.9   | -       | 5,810.9   |
| Asset-backed securities                | -       | 592.1     | -       | 592.1     |
| Canadian government obligations and    |         |           |         |           |
| Canadian government agency obligations | -       | 1,078.5   | -       | 1,078.5   |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|                                     |        |            |     |            |
|-------------------------------------|--------|------------|-----|------------|
| Other securities                    | 25.0   | 2,488.3    | -   | 2,513.3    |
| Total available-for-sale securities | \$25.0 | \$16,645.3 | \$- | \$16,670.3 |

The following table presents the Company's assets measured at fair value on a recurring basis at June 30, 2010. Included in the table are available-for-sale securities within corporate investments of \$132.2 million and funds held for clients of \$15,384.8 million.

|  | Level 1 | Level 2    | Level 3 | Total      |
|--|---------|------------|---------|------------|
| U.S Treasury and direct obligations of |         |            |         |            |
| U.S. government agencies               | \$-     | \$5,911.4  | \$-     | \$5,911.4  |
| Corporate bonds                        | -       | 5,332.9    | -       | 5,332.9    |
| Asset-backed securities                | -       | 968.9      | -       | 968.9      |
| Canadian government obligations and    |         |            |         |            |
| Canadian government agency obligations | -       | 1,032.5    | -       | 1,032.5    |
| Other securities                       | 8.0     | 2,263.3    | -       | 2,271.3    |
| Total available-for-sale securities    | \$8.0   | \$15,509.0 | \$-     | \$15,517.0 |

Note 9. Receivables

Accounts receivable, net, includes the Company's trade receivables, which are recorded based upon the amount the Company expects to receive from its clients, net of an allowance for doubtful accounts. The Company's receivables also include notes receivable for the financing of the sale of computer systems, primarily from automotive, heavy truck and powersports dealers. Notes receivable are recorded based upon the amount the Company expects to receive from its clients, net of an allowance for doubtful accounts and unearned income. The allowance for doubtful accounts is the Company's best estimate of probable credit losses related to trade receivables and notes receivable based upon the aging of the receivables, historical collection data, internal assessments of credit quality and the economic conditions in the automobile industry, as well as in the economy as a whole. The Company charges off uncollectable amounts against the reserve in the period in which it determines they are uncollectable. Unearned income on notes receivable is amortized using the effective interest method.

The Company's receivables, whose carrying value approximates fair value, are as follows:

|   | March 31, 2011 |           | June 30, 2010 |           |
|---|----------------|-----------|---------------|-----------|
|   | Current        | Long-term | Current       | Long-term |
| Trade receivables                                   | \$1,268.4      | \$-       | \$1,076.3     | \$-       |
| Notes receivable                                    | 92.3           | 148.5     | 110.3         | 155.0     |
| Less:   |                |           |               |           |
| Allowance for doubtful accounts - trade receivables | (49.4 )        | -         | (39.6 )       | -         |
| Allowance for doubtful accounts - notes receivable  | (8.7 )         | (14.5 )   | (9.4 )        | (16.1 )   |
| Unearned income-notes receivable                    | (8.8 )         | (8.7 )    | (9.9 )        | (9.5 )    |
| Total   | \$1,293.8      | \$125.3   | \$1,127.7     | \$129.4   |

The Company determines the allowance for doubtful accounts related to notes receivable based upon a specific reserve for known collection issues, as well as a non-specific reserve based upon aging, both of which are based upon history of such losses and current economic conditions. Based upon our methodology, the notes receivable balances with specific and non-specific reserves and the specific and non-specific reserves associated with those balances are as

follows:

|                      | March 31, 2011   |                |              |               |
|----------------------|------------------|----------------|--------------|---------------|
|                      | Notes Receivable |                | Reserve      |               |
|                      | Current          | Long-term      | Current      | Long-term     |
| Specific Reserve     | \$2.5            | \$4.2          | \$2.5        | \$4.2         |
| Non-specific Reserve | 89.8             | 144.3          | 6.2          | 10.3          |
| <b>Total</b>         | <b>\$92.3</b>    | <b>\$148.5</b> | <b>\$8.7</b> | <b>\$14.5</b> |

|                      | June 30, 2010    |                |              |               |
|----------------------|------------------|----------------|--------------|---------------|
|                      | Notes Receivable |                | Reserve      |               |
|                      | Current          | Long-term      | Current      | Long-term     |
| Specific Reserve     | \$3.8            | \$6.6          | \$3.8        | \$6.6         |
| Non-specific Reserve | 106.5            | 148.4          | 5.6          | 9.5           |
| <b>Total</b>         | <b>\$110.3</b>   | <b>\$155.0</b> | <b>\$9.4</b> | <b>\$16.1</b> |

The rollforward of the allowance for doubtful accounts related to notes receivable is as follows:

|                                  | Current      | Long-term   |
|----------------------------------|--------------|-------------|
| Balance at June 30, 2010         | \$9.4        | \$16.1      |
| Incremental provision            | 1.3          | 2.2         |
| Recoveries                       | (0.7 )       | (1.5 )      |
| Chargeoffs                       | (1.3 )       | (2.3 )      |
| <b>Balance at March 31, 2011</b> | <b>\$8.7</b> | <b>14.5</b> |

As of both March 31, 2011 and June 30, 2010, the allowance for doubtful accounts as a percentage of notes receivable is approximately 10%.

Notes receivable aged over 30 days past due are considered delinquent. Notes receivable aged over 60 days past due and notes receivable with known collection issues are placed on non-accrual status. Interest revenue is not recognized on notes receivable while on non-accrual status. Cash payments received on non-accrual receivables is applied towards principal. When notes receivable on non-accrual status are again less than 60 days past due, recognition of interest revenue for notes receivable is resumed. At March 31, 2011, the Company had \$1.8 million in notes receivable on non-accrual status, including \$0.5 million of notes receivable aged over 60 days past due.

On an ongoing basis, the Company evaluates the credit quality of its financing receivables, utilizing aging of receivables, collection experience and charge-offs. In addition, the Company evaluates economic conditions in the automotive industry and specific dealership matters, such as bankruptcy. As events related to a specific client dictate, the credit quality of a client is reevaluated.

The aging of the notes receivable past due at March 31, 2011 is as follows:

|                   | Over 30 days to 60 days | Over 60 days |
|-------------------|-------------------------|--------------|
| Notes Receivables | \$ 2.0                  | \$ 0.5       |

At March 31, 2011, approximately 99% of notes receivable are current. During the nine months ended March 31, 2011, the charge-offs as a percentage of notes receivable were 1%.

## Note 10. Goodwill and Intangible Assets, net

Changes in goodwill for the nine months ended March 31, 2011 are as follows:

|                                      | Employer<br>Services | PEO<br>Services | Dealer<br>Services | Total     |
|--------------------------------------|----------------------|-----------------|--------------------|-----------|
| Balance as of June 30, 2010          | \$1,611.3            | \$4.8           | \$767.2            | \$2,383.3 |
| Additions and other adjustments, net | 262.1                | -               | 334.4              | 596.5     |
| Currency translation adjustments     | 61.7                 | -               | 30.5               | 92.2      |
| Balance as of March 31, 2011         | \$1,935.1            | \$4.8           | \$1,132.1          | \$3,072.0 |

Components of intangible assets, net, are as follows:

|                                | March 31,<br>2011 | June 30,<br>2010 |
|--------------------------------|-------------------|------------------|
| Intangible assets:             |                   |                  |
| Software and software licenses | \$1,293.4         | \$1,160.0        |
| Customer contracts and lists   | 816.5             | 640.3            |
| Other intangibles              | 237.1             | 209.5            |
|                                | 2,347.0           | 2,009.8          |
| Less accumulated amortization: |                   |                  |
| Software and software licenses | (1,043.2 )        | (946.0 )         |
| Customer contracts and lists   | (429.0 )          | (375.6 )         |
| Other intangibles              | (156.1 )          | (145.8 )         |
|                                | (1,628.3 )        | (1,467.4 )       |
| Intangible assets, net         | \$718.7           | \$542.4          |

Other intangibles consist primarily of purchased rights, covenants not to compete, patents and trademarks (acquired directly or through acquisitions). All of the intangible assets have finite lives and, as such, are subject to amortization. The weighted average remaining useful life of the intangible assets is 8 years (4 years for software and software licenses, 11 years for customer contracts and lists, and 8 years for other intangibles). Amortization of intangible assets totaled \$45.0 million and \$39.6 million for the three months ended March 31, 2011 and 2010, respectively, and totaled \$130.3 million and \$115.7 million for the nine months ended March 31, 2011 and 2010, respectively.

Estimated future amortization expense of the Company's existing intangible assets is as follows:

|                                    | Amount  |
|------------------------------------|---------|
| Three months ending June 30, 2011  | \$44.3  |
| Twelve months ending June 30, 2012 | \$163.1 |
| Twelve months ending June 30, 2013 | \$118.8 |
| Twelve months ending June 30, 2014 | \$85.9  |
| Twelve months ending June 30, 2015 | \$65.2  |
| Twelve months ending June 30, 2016 | \$49.0  |

The Company has not incurred significant costs to renew or extend the term of acquired intangible assets during the nine months ended March 31, 2011.

## Note 11. Short-term Financing

The Company has a \$2.5 billion, 364-day credit agreement with a group of lenders that matures in June 2011. In addition, the Company has a three-year \$1.5 billion credit facility maturing in June 2013 that contains an accordion feature under which the aggregate commitment can be increased by \$500.0 million, subject to the availability of additional commitments. The Company also has an existing \$2.25 billion five-year credit facility that matures in June 2011 that also contains an accordion feature under which the aggregate commitment can be increased by \$500.0 million, subject to the availability of additional commitments. The interest rate applicable to the committed borrowings is tied to LIBOR, the federal funds effective rate or the prime rate depending on the notification provided by the Company to the syndicated financial institutions prior to borrowing. The Company is also required to pay facility fees on the credit agreements. The primary uses of the credit facilities are to provide liquidity to the commercial paper program and to provide funding for general corporate purposes, if necessary. The Company had no borrowings through March 31, 2011 under the credit agreements.

The Company's U.S. short-term funding requirements related to client funds are sometimes obtained through a short-term commercial paper program, which provides for the issuance of up to \$6.25 billion in aggregate maturity value of commercial paper. The Company's commercial paper program is rated A-1+ by Standard and Poor's and Prime-1 by Moody's. These ratings denote the highest quality commercial paper securities. Maturities of commercial paper can range from overnight to up to 364 days. At March 31, 2011 and June 30, 2010, the Company had no commercial paper outstanding. For the three months ended March 31, 2011 and 2010, the Company's average borrowings were \$0.6 billion at a weighted average interest rate of 0.2% for both periods. For the nine months ended March 31, 2011 and 2010, the Company's average borrowings were \$1.7 billion and \$1.8 billion, respectively, at a weighted average interest rate of 0.2% for both periods. The weighted average maturity of the Company's commercial paper during each of the three and nine months ended March 31, 2011 and 2010 was less than two days.

The Company's U.S. and Canadian short-term funding requirements related to client funds obligations are sometimes obtained on a secured basis through the use of reverse repurchase agreements. These agreements are collateralized principally by government and government agency securities. These agreements generally have terms ranging from overnight to up to five business days. The Company has \$2 billion available to it on a committed basis under these reverse repurchase agreements. At March 31, 2011 and June 30, 2010, there were no outstanding obligations under reverse repurchase agreements. For the three months ended March 31, 2011 and 2010, the Company had average outstanding balances under reverse repurchase agreements of \$160.3 million and \$109.0 million, respectively, at weighted average interest rates of 0.8% and 0.2%, respectively. For the nine months ended March 31, 2011 and 2010, the Company had average outstanding balances under reverse repurchase agreements of \$439.0 million and \$367.8 million, respectively, at weighted average interest rates of 0.5% and 0.2%, respectively.

## Note 12. Debt

Components of long-term debt are as follows:

|                          | March 31,<br>2011 | June 30,<br>2010 |
|--------------------------|-------------------|------------------|
| Industrial revenue bonds | \$21.6            | \$25.4           |
| Secured financing        | 15.8              | 17.2             |
|                          | 37.4              | 42.6             |
| Less: current portion    | (2.8 )            | (2.8 )           |
|                          | \$34.6            | \$39.8           |

The fair value of the industrial revenue bonds and other debt included above approximates carrying value.

#### Note 13. Employee Benefit Plans

A. Stock Plans. The Company recognizes stock-based compensation expense in net earnings based on the fair value of the award on the date of grant. Stock-based compensation consists of the following:

- Stock Options. Stock options are granted to employees at exercise prices equal to the fair market value of the Company's common stock on the dates of grant. Stock options are issued under a grade vesting schedule. Options granted prior to July 1, 2008 generally vest ratably over five years and have a term of 10 years. Options granted after July 1, 2008 generally vest ratably

over four years and have a term of 10 years. Compensation expense for stock options is recognized over the requisite service period for each separately vesting portion of the stock option award.

- Employee Stock Purchase Plan.

- o Prior to January 1, 2009, the Company offered an employee stock purchase plan that allowed eligible employees to purchase shares of common stock at a price equal to 85% of the market value for the common stock at the date the purchase price for the offering was determined. No further compensation expense related to this stock purchase plan was recorded after the completion of the vesting period of the final offering under such plan on December 31, 2009.

- o Subsequent to June 30, 2009, the Company offers an employee stock purchase plan that allows eligible employees to purchase shares of common stock at a price equal to 95% of the market value for the Company's common stock on the last day of the offering period. This plan has been deemed non-compensatory and therefore, no compensation expense has been recorded.

- Restricted Stock.

- o Time-Based Restricted Stock. The Company has issued time-based restricted stock to certain key employees. These shares are restricted as to transfer and in certain circumstances must be returned to the Company at the original purchase price. The Company records stock compensation expense relating to the issuance of restricted stock based on market prices on the date of grant on a straight-line basis over the period in which the transfer restrictions exist, which is up to five years from the date of grant.

- o Performance-Based Restricted Stock. The performance-based restricted stock program has a one-year performance period, and a subsequent six-month service period. Under this program, the Company communicates "target awards" to employees at the beginning of a performance period and, as such, dividends are not paid in respect of the "target awards" during the performance period. After the performance period, if the performance targets are achieved, associates are eligible to receive dividends on any shares awarded under the program. The performance target is based on EPS growth over the performance period, with possible payouts ranging from 0% to 150% of the "target awards". Stock-based compensation expense is measured based upon the fair value of the award on the grant date. Compensation expense is recognized on a straight-line basis over the vesting terms of approximately 18 months, based upon the probability the performance target will be met.

The Company currently utilizes treasury stock to satisfy stock option exercises, issuances under the Company's employee stock purchase plan and restricted stock awards. Stock-based compensation expense of \$21.8 million and \$18.2 million was recognized in earnings from continuing operations for the three months ended March 31, 2011 and 2010, respectively, as well as related tax benefits of \$8.2 million and \$6.8 million, respectively. Stock-based

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

compensation expense of \$58.5 million and \$55.0 million was recognized in earnings from continuing operations for the nine months ended March 31, 2011 and 2010, respectively, as well as related tax benefits of \$21.8 million and \$17.6 million, respectively.

|   | Three Months Ended<br>March 31, |        | Nine Months Ended<br>March 31, |        |
|---|---------------------------------|--------|--------------------------------|--------|
|   | 2011                            | 2010   | 2011                           | 2010   |
| Operating expenses                            | \$4.2                           | \$3.1  | \$10.8                         | \$9.6  |
| Selling, general and administrative expenses  | 13.6                            | 12.1   | 37.4                           | 37.5   |
| System development and programming costs      | 4.0                             | 3.0    | 10.3                           | 7.9    |
| Total pretax stock-based compensation expense | \$21.8                          | \$18.2 | \$58.5                         | \$55.0 |

As of March 31, 2011, the total remaining unrecognized compensation cost related to non-vested stock options and restricted stock awards was \$12.2 million and \$51.3 million, respectively, which will be amortized over the weighted-average remaining requisite service periods of 1.6 years and 1.3 years, respectively.

During the nine months ended March 31, 2011, the following activity occurred under our existing plans:

Stock Options:

|  | Number<br>of Options<br>(in<br>thousands) | Weighted<br>Average<br>Price<br>(in dollars) |
|--|---|--|
| Options outstanding at<br>July 1, 2010   | 35,000                                    | \$41   |
| Options granted                          | 1,398                                     | \$38   |
| Options exercised                        | (8,384 )                                  | \$41   |
| Options canceled                         | (3,112 )                                  | \$53   |
| Options outstanding at<br>March 31, 2011 | 24,902                                    | \$40   |

Performance-Based Restricted Stock:

|  | Number<br>of Shares<br>(in<br>thousands) |
|--|--|
| Restricted shares outstanding<br>at July 1, 2010 | 1,112                                    |
| Restricted shares granted                        | 1,388                                    |
| Restricted shares vested                         | (1,075)                                  |
| Restricted shares forfeited                      | (56)                                     |
| Restricted shares outstanding                    |  |



at March 31, 2011

1,369

The fair value of each stock option issued prior to January 1, 2005 was estimated on the date of grant using a Black-Scholes option pricing model. For stock options issued on or after January 1, 2005, the fair value of each stock option was estimated on the date of grant using a binomial option pricing model. The binomial model considers a range of assumptions related to volatility, risk-free interest rate and employee exercise behavior. Expected volatilities utilized in the binomial model are based on a combination of implied market volatilities, historical volatility of the Company's stock price and other factors. Similarly, the dividend yield is based on historical experience and expected future changes. The risk-free rate is derived from the U.S. Treasury yield curve in effect at the time of grant. The binomial model also incorporates exercise and forfeiture assumptions based on an analysis of historical data. The expected life of the stock option grants is derived from the output of the binomial model and represents the period of time that options granted are expected to be outstanding.

The fair value for stock options granted was estimated at the date of grant with the following assumptions:

|   | Nine Months Ended<br>March 31, |                   |
|---|--------------------------------|-------------------|
|   | 2011                           | 2010              |
| Risk-free interest rate                   | 1.4% -<br>2.4 %                | 2.3% -<br>2.6 %   |
| Dividend yield                            | 2.9% -<br>3.3 %                | 3.2% -<br>3.4 %   |
| Weighted average volatility factor        | 24.5% -<br>24.9 %              | 25.9% -<br>30.4 % |
| Weighted average expected life (in years) | 5.1 - 5.2                      | 5.0 - 5.1         |
| Weighted average fair value (in dollars)  | \$ 7.59                        | \$ 7.05           |

## B. Pension Plans

The components of net pension expense were as follows:

|  | Three months ended<br>March 31, |         | Nine months ended<br>March 31, |         |
|--|---------------------------------|---------|--------------------------------|---------|
|  | 2011                            | 2010    | 2011                           | 2010    |
| Service cost – benefits earned during the period | \$13.1                          | \$11.9  | \$39.3                         | \$35.7  |
| Interest cost on projected benefits              | 14.1                            | 14.7    | 42.3                           | 44.4    |
| Expected return on plan assets                   | (22.1 )                         | (19.1 ) | (66.3 )                        | (57.4 ) |
| Net amortization and deferral                    | 5.0                             | 1.1     | 15.0                           | 3.3     |
| Net pension expense                              | \$10.1                          | \$8.6   | \$30.3                         | \$26.0  |

During the nine months ended March 31, 2011, the Company contributed \$156.5 million to the pension plans and expects to contribute approximately \$2.0 million during the remainder of the fiscal year ending June 30, 2011 (“fiscal 2011”).

## Note 14. Income Taxes

The effective tax rate for the three months ended March 31, 2011 and 2010 was 35.1% and 36.6%, respectively. When compared to the effective tax rate for the three months ended March 31, 2010, the reduction in the effective tax rate for the three months ended March 31, 2011 is attributable to a decrease in federal and state income tax expense and a

favorable mix of earnings in foreign jurisdictions.

The effective tax rate for the nine months ended March 31, 2011 and 2010 was 35.7% and 35.8%, respectively. The reduction in the effective tax rate for the nine months ended March 31, 2011 is due to the resolution of certain tax matters in the nine month period ended March 31, 2010 that resulted in a decrease to the effective tax rate of 0.8 percentage points for that period, offset by a decrease in federal and state income tax expense and a favorable mix of earnings in foreign jurisdictions for the nine months ended March 31, 2011.

Note 15. Commitments and Contingencies

In September 2010, a purported class action lawsuit was filed against the Company in Superior Court of the State of California, County of Los Angeles. The lawsuit was subsequently removed to the United States District Court, Central District of California, Western Division. The complaint alleges that the Company unlawfully handled certain client calls and seeks statutory damages. The services at issue were performed by an independent third-party vendor, and the Company believes that it has the contractual right to full indemnification from this vendor for any potential losses it might incur with respect to the matter.

In April 2011, the Company and the third-party vendor entered into an agreement with the plaintiff to settle the matter subject to court approval. As part of the settlement, the Company is to be dismissed from the action and the third-party vendor will pay all settlement amounts. The third-party vendor is also paying all of the Company's legal fees and costs associated with defense of the matter. A class action settlement agreement is expected to be submitted to the court for preliminary approval in the fourth quarter of fiscal 2011.

The Company is subject to various other claims and litigation in the normal course of business. The Company does not believe that the resolution of these matters will have a material impact on the consolidated financial statements.

In the normal course of business, the Company also enters into contracts in which it makes representations and warranties that relate to the performance of the Company's services and products. The Company does not expect any material losses related to such representations and warranties.

The Company has obligations under various facilities and equipment leases and software license agreements that were disclosed in its Annual Report on Form 10-K for the year ended June 30, 2010.

Note 16. Foreign Currency Risk Management Programs

The Company is exposed to market risk from changes in foreign currency exchange rates that could impact our consolidated results of operations, financial position or cash flows. The Company manages its exposure to these market risks through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. The Company uses derivative financial instruments as risk management tools and not for trading purposes.

The Company had no derivative financial instruments outstanding at March 31, 2011 or June 30, 2010.

Note 17. Comprehensive Income

|                                  | Three Months Ended<br>March 31, |         | Nine Months Ended<br>March 31, |           |
|----------------------------------|---------------------------------|---------|--------------------------------|-----------|
|                                  | 2011                            | 2010    | 2011                           | 2010      |
| Net earnings                     | \$423.8                         | \$403.6 | \$1,012.4                      | \$1,003.5 |
| Other comprehensive income:      |                                 |         |                                |           |
| Currency translation adjustments | 58.8                            | (63.7 ) | 143.2                          | (2.9 )    |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|   |         |         |           |           |
|---|---------|---------|-----------|-----------|
| Unrealized gain (loss) on available-for-sale securities, net of tax | (59.7 ) | 17.6    | (156.7 )  | 110.4     |
| Pension liability adjustment, net of tax                            | 2.3     | 1.7     | 2.9       | 3.2       |
| Comprehensive income  | \$425.2 | \$359.2 | \$1,001.8 | \$1,114.2 |

Note 18. Interim Financial Data by Segment

The Company's strategic business units are aggregated into the following three reportable segments: Employer Services, PEO Services and Dealer Services. The primary components of "Other" are financing transactions related to the sale of computer systems, corporate allocations and certain expenses that have not been charged to the reportable segments, including stock-based compensation expense. Certain revenues and expenses are charged to the reportable segments at a standard rate for management reasons. Other costs are recorded based on management responsibility. The prior year reportable segments' revenues and earnings from continuing operations before income taxes have been adjusted to reflect updated budgeted foreign exchange rates for fiscal 2011. In addition, there is a reconciling item for the difference between actual interest income earned on invested funds held for clients and interest credited to Employer Services and PEO Services at a standard rate of 4.5%. The reportable segments' results also include an internal cost of capital charge related to the funding of acquisitions and other investments. All of these adjustments/charges are reconciling items to the Company's reportable segments' revenues and/or earnings from continuing operations before income taxes and results in the elimination of these adjustments/charges in consolidation.

Segment Results:

|                      | Revenues           |           |                   |           |
|----------------------|--------------------|-----------|-------------------|-----------|
|                      | Three Months Ended |           | Nine Months Ended |           |
|                      | March 31,          |           | March 31,         |           |
|                      | 2011               | 2010      | 2011              | 2010      |
| Employer Services    | \$1,925.1          | \$1,768.8 | \$5,147.3         | \$4,801.0 |
| PEO Services         | 447.8              | 378.5     | 1,147.3           | 985.9     |
| Dealer Services      | 391.5              | 304.5     | 1,103.2           | 904.6     |
| Other                | 3.7                | 5.4       | 10.0              | 14.4      |
| Reconciling items:   |                    |           |                   |           |
| Foreign exchange     | 48.1               | 41.0      | 107.8             | 124.8     |
| Client fund interest | (78.9 )            | (55.0 )   | (143.2 )          | (93.3 )   |
| Total                | \$2,737.3          | \$2,443.2 | \$7,372.4         | \$6,737.4 |

|                        | Earnings from Continuing Operations before Income Taxes |         |                   |           |
|------------------------|---|---------|-------------------|-----------|
|                        | Three Months Ended                                      |         | Nine Months Ended |           |
|                        | March 31,   |         | March 31,         |           |
|                        | 2011  | 2010    | 2011              | 2010      |
| Employer Services      | \$646.9   | \$600.2 | \$1,455.1         | \$1,384.7 |
| PEO Services           | 37.8  | 30.0    | 102.0             | 97.9      |
| Dealer Services        | 67.5  | 58.6    | 175.8             | 157.0     |
| Other                  | (58.5 )   | (33.9 ) | (110.2 )          | (81.9 )   |
| Reconciling items:     |   |         |                   |           |
| Foreign exchange       | 8.9   | 7.4     | 11.8              | 14.6      |
| Client fund interest   | (78.9 )   | (55.0 ) | (143.2 )          | (93.3 )   |
| Cost of capital charge | 29.3  | 25.7    | 82.7              | 78.7      |

|       |         |         |           |           |
|-------|---------|---------|-----------|-----------|
| Total | \$653.0 | \$633.0 | \$1,574.0 | \$1,557.7 |
|-------|---------|---------|-----------|-----------|

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(Tabular dollars are presented in millions, except per share amounts)

### FORWARD-LOOKING STATEMENTS

This report and other written or oral statements made from time to time by ADP may contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Statements that are not historical in nature and which may be identified by the use of words like "expects," "assumes," "projects," "anticipates," "estimates," "we believe," "could be" and other words of similar meaning, are forward-looking statements. These statements are based on management's expectations and assumptions and are subject to risks and uncertainties that may cause actual results to differ materially from those expressed. Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include: ADP's success in obtaining, retaining and selling additional services to clients; the pricing of products and services; changes in laws regulating payroll taxes, professional employer organizations and employee benefits; overall market and economic conditions, including interest rate and foreign currency trends; competitive conditions; auto sales and related industry changes; employment and wage levels; changes in technology; availability of skilled technical associates and the impact of new acquisitions and divestitures. ADP disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. These risks and uncertainties, along with the risk factors discussed under "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010, should be considered in evaluating any forward-looking statements contained herein.

### CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates, judgments and assumptions that affect reported amounts of assets, liabilities, revenues and expenses. We continually evaluate the accounting policies and estimates used to prepare the consolidated financial statements. The estimates are based on historical experience and assumptions believed to be reasonable under current facts and circumstances. Actual amounts and results could differ from these estimates made by management. Certain accounting policies that require significant management estimates and are deemed critical to our results of operations or financial position are discussed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2010 in the Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

### RESULTS OF OPERATIONS

#### Executive Overview

While ADP's fiscal 2010 was a challenging year and our results were impacted by the economic downturn, including high unemployment levels, record-low interest rates and volatile financial markets, during the first nine months of fiscal 2011 we have seen positive trends in our key business metrics. The improving economy, coupled with our investments in client service, resulted in increased client revenue retention in Employer Services, as well as an increase in pays per control in the U.S. We have continued to see growth in PEO Services in the first nine months of fiscal 2011, with increases in average worksite employees driving growth in the business. Within Dealer Services, the automotive sector continued to stabilize and we are beginning to see dealership closures subsiding and transactional revenues related to credit checks and vehicle registrations increasing.

We continue to have a strong business model, which has predominately recurring revenues, excellent margins from the ability to generate consistent, healthy cash flows, strong client retention and low capital expenditure requirements. During the first nine months of fiscal 2011, we have continued to return excess cash to our shareholders. In addition, in the first nine months of fiscal 2011, we have also raised the dividend payout per share for the 36th consecutive year. We invest our clients' funds in accordance with ADP's prudent and conservative investment guidelines. The safety, liquidity and diversification of our clients' funds are the foremost objectives of our investment strategy.

Lastly, in the first nine months of fiscal 2011, we completed the acquisition of eight businesses, including Cobalt, a leading provider of digital marketing solutions for the automotive industry. The Cobalt acquisition aligns with ADP Dealer Services' global layered applications strategy and strongly supports Dealer Services' long-term growth strategy. We expect that these acquisitions will not have a material impact on our earnings for fiscal 2011.

#### Analysis of Consolidated Operations

|   | Three Months Ended |                   | \$ Change  | % Change |
|---|--------------------|-------------------|------------|----------|
|   | 2011               | March 31,<br>2010 |            |          |
| Total revenues  | \$ 2,737.3         | \$ 2,443.2        | \$ 294.1   | 12%      |
| Costs of revenues:                                      |                    |                   |            |          |
| Operating expenses                                      | \$ 1,300.3         | \$ 1,140.3        | \$ 160.0   | 14%      |
| Systems development and programming costs               | 155.8              | 130.0             | 25.8       | 20%      |
| Depreciation and amortization                           | 64.5               | 60.4              | 4.1        | 7%       |
| Total costs of revenues                                 | \$ 1,520.6         | \$ 1,330.7        | \$ 189.9   | 14%      |
| Selling, general and administrative expenses            | 577.3              | 504.9             | 72.4       | 14%      |
| Interest expense  | 1.4                | 1.2               | 0.2        | 17%      |
| Total expenses  | \$ 2,099.3         | \$ 1,836.8        | \$ 262.5   | 14%      |
| Other income, net                                       | \$ (15.0 )         | \$ (26.6 )        | \$ (11.6 ) | (44)%    |
| Earnings from continuing operations before income taxes | \$ 653.0           | \$ 633.0          | \$ 20.0    | 3%       |
| Margin  | 24 %               | 26 %              |            |          |
| Provision for income taxes                              | \$ 229.2           | \$ 231.4          | \$ (2.2 )  | (1)%     |
| Effective tax rate                                      | 35.1 %             | 36.6 %            |            |          |
| Net earnings from continuing operations                 | \$ 423.8           | \$ 401.6          | \$ 22.2    | 6%       |
| Earnings from discontinued operations                   | \$ -               | \$ 2.0            | \$ (2.0 )  | (100)%   |
| Diluted earnings per share                              |                    |                   |            |          |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

| from continuing operations                              | \$ 0.85                        | \$ 0.79   | \$ 0.06   | 8%       |
|---|--------------------------------|-----------|-----------|----------|
|   | Nine Months Ended<br>March 31, |           |           |          |
|   | 2011                           | 2010      | \$ Change | % Change |
| Total revenues  | \$7,372.4                      | \$6,737.4 | \$635.0   | 9%       |
| Costs of revenues:                                      |                                |           |           |          |
| Operating expenses                                      | \$3,590.5                      | \$3,190.6 | \$399.9   | 13%      |
| Systems development and programming costs               | 432.9                          | 376.2     | 56.7      | 15%      |
| Depreciation and amortization                           | 189.4                          | 180.6     | 8.8       | 5%       |
| Total costs of revenues                                 | \$4,212.8                      | \$3,747.4 | \$465.4   | 12%      |
| Selling, general and administrative expenses            | \$1,663.0                      | \$1,515.5 | \$147.5   | 10%      |
| Interest expense  | 6.9                            | 6.8       | 0.1       | 1%       |
| Total expenses  | \$5,882.7                      | \$5,269.7 | \$613.0   | 12%      |
| Other income, net                                       | \$(84.3 )                      | \$(90.0 ) | \$(5.7 )  | (6)%     |
| Earnings from continuing operations before income taxes | \$1,574.0                      | \$1,557.7 | \$16.3    | 1%       |
| Margin  | 21 %                           | 23 %      |           |          |
| Provision for income taxes                              | \$561.6                        | \$558.0   | \$3.6     | 1%       |
| Effective tax rate                                      | 35.7 %                         | 35.8 %    |           |          |
| Net earnings from continuing operations                 | \$1,012.4                      | \$999.7   | \$12.7    | 1%       |
| Earnings from discontinued operations                   | \$-                            | \$3.8     | \$(3.8 )  | (100)%   |
| Diluted earnings per share from continuing operations   | \$2.03                         | \$1.98    | \$0.05    | 3%       |

Total Revenues

Total revenues grew 12%, to \$2,737.3 million for the three months ended March 31, 2011, from \$2,443.2 million for the three months ended March 31, 2010, due to increases in revenues in Employer Services of 9%, or \$156.3 million, to \$1,925.1 million, PEO Services of 18%, or \$69.3 million, to \$447.8 million, and Dealer Services of 29%, or \$87.0 million, to \$391.5 million. In addition, our revenues increased by \$2.5 million due to changes in foreign currency exchange rates. Total revenues would have increased approximately 7% without the impact of recently completed acquisitions.

Total revenues for the three months ended March 31, 2011 include interest on funds held for clients of \$148.6 million, as compared to \$147.9 million for the three months ended March 31, 2010. The increase in the consolidated interest earned on funds held for clients resulted from the increase in our average client funds balances of 12%, to \$20.6

## Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

billion, for the three months ended March 31, 2011, offset by a decrease in the average interest rate earned to 2.9% during the three months ended March 31, 2011 as compared to 3.2% for the three months ended March 31, 2010.

Total revenues grew 9%, to \$7,372.4 million for the nine months ended March 31, 2011, from \$6,737.4 million for the nine months ended March 31, 2010, due to increases in revenues in Employer Services of 7%, or \$346.3 million, to \$5,147.3 million, PEO Services of 16%, or \$161.4 million, to \$1,147.3 million, and Dealer Services of 22%, or \$198.6 million, to \$1,103.2 million. Such increases were partially offset by changes in foreign currency exchange rates, which reduced our revenues by \$27.8 million. Total revenues would have increased approximately 5% without the impact of recently completed acquisitions.

Total revenues for the nine months ended March 31, 2011 include interest on funds held for clients of \$404.4 million, as compared to \$403.5 million for the nine months ended March 31, 2010. The increase in the consolidated interest earned on funds held for clients resulted from the increase in our average client funds balances of 10%, to \$16.3 billion, for the nine months ended March 31, 2011, offset by a decrease in the average interest rate earned to 3.3% during the nine months ended March 31, 2011 as compared to 3.6% for the nine months ended March 31, 2010.

### Total Expenses

Total expenses increased 14%, to \$2,099.3 million for the three months ended March 31, 2011, from \$1,836.8 million for the three months ended March 31, 2010. The increase in our consolidated expenses was due to an increase in operating expenses of \$160.0 million, an increase in selling, general and administrative expenses of \$72.4 million and an increase in systems development and programming expenses of \$25.8 million.

Total expenses increased 12%, to \$5,882.7 million for the nine months ended March 31, 2011, from \$5,269.7 million for the nine months ended March 31, 2010. The increase in our consolidated expenses was due to an increase in operating expenses of \$399.9 million, an increase in selling, general and administrative expenses of \$147.5 million and an increase in systems development and programming expenses of \$56.7 million.

Total costs of revenues increased 14%, to \$1,520.6 million for the three months ended March 31, 2011, from \$1,330.7 million for the three months ended March 31, 2010, due to an increase in operating expenses of \$160.0 million and an increase in systems development and programming expenses of \$25.8 million.

Total costs of revenues increased 12%, to \$4,212.8 million for the nine months ended March 31, 2011, from \$3,747.4 million for the nine months ended March 31, 2010, due to an increase in operating expenses of \$399.9 million and an increase in systems development and programming expenses of \$56.7 million.

Operating expenses increased \$160.0 million, or 14%, for the three months ended March 31, 2011, compared to the three months ended March 31, 2010 due to the increase in revenues described above, including the increases in PEO Services, which has pass-through costs that are re-billable including costs for benefits coverage, workers' compensation coverage and state unemployment taxes for worksite employees. These pass-through costs were \$349.6 million for the three months ended March 31, 2011, which included costs for benefits coverage of \$238.6 million and costs for workers compensation and payment of state unemployment taxes of \$111.0 million. These costs were \$294.5 million for the three months ended March 31, 2010, which included costs for benefits coverage of \$208.1 million and costs for workers compensation and payment of state unemployment taxes of \$86.4 million. The increase in operating expenses is also due to operating expenses related to businesses acquired of \$68.0 million and higher expenses in Employer Services of \$13.1 million related to increased service costs for investment in client-facing associates.

Operating expenses increased \$399.9 million, or 13%, for the nine months ended March 31, 2011, compared to the nine months ended March 31, 2010 due to the increase in revenues described above, including the increases in PEO

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

Services, which has pass-through costs that are re-billable including costs for benefits coverage, workers' compensation coverage and state unemployment taxes for worksite employees. These pass-through costs were \$880.3 million for the nine months ended March 31, 2011, which included costs for benefits coverage of \$691.1 million and costs for workers compensation and payment of state unemployment taxes of \$189.2 million. These costs were \$748.5 million for the nine months ended March 31, 2010, which included costs for benefits coverage of \$599.9 million and costs for workers compensation and payment of state unemployment taxes of \$148.6 million. The increase in operating expenses is also due to operating expenses related to businesses acquired of \$156.2 million and higher expenses in Employer Services of \$37.0 million related to increased service costs for investment in client-facing associates. Additionally, operating expenses increased due to the settlement of a PEO Services state unemployment matter that reduced operating expenses by \$9.2 million during the nine months ended March 31, 2010. Such increases were partially offset by a decrease of approximately \$18.0 million due to changes in foreign currency exchange rates.

Systems development and programming expenses increased \$25.8 million, or 20%, for the three months ended March 31, 2011, compared to the three months ended March 31, 2010 due to businesses acquired of \$12.0 million.

Systems development and programming expenses increased \$56.7 million, or 15%, for the nine months ended March 31, 2011, compared to the nine months ended March 31, 2010 due to businesses acquired of \$29.8 million, partially offset by a decrease of approximately \$3.4 million due to changes in foreign currency exchange rates.

Selling, general and administrative expenses increased \$72.4 million, or 14%, for the three months ended March 31, 2011, compared to the three months ended March 31, 2010, which was attributable to higher selling expenses of \$26.3 million due to increases in headcount over prior year levels and due to selling, general and administrative expenses of acquired businesses of \$28.5 million.

Selling, general and administrative expenses increased \$147.5 million, or 10%, for the nine months ended March 31, 2011, compared to the nine months ended March 31, 2010, which was attributable to higher selling expenses of \$73.6 million due to increases in headcount over prior year levels and due to selling, general and administrative expenses of acquired businesses of \$74.2 million. Such increases were partially offset by an asset impairment charge of \$6.8 million during the three months ended September 30, 2009 related to the announcement by General Motors Company that it will shut down its Saturn division. Lastly, there was a decrease of \$8.3 million due to changes in foreign currency exchange rates.

Other income, net

|  | Three Months Ended<br>March 31, |           |           | Nine Months Ended<br>March 31, |           |           |
|--|---------------------------------|-----------|-----------|--------------------------------|-----------|-----------|
|  | 2011                            | 2010      | \$ Change | 2011                           | 2010      | \$ Change |
| Interest income on corporate funds                 | \$(10.0 )                       | \$(10.6 ) | \$(0.6 )  | \$(68.8 )                      | \$(78.2 ) | \$(9.4 )  |
| Realized gains on available-for-sale securities    | (5.4 )                          | (1.5 )    | 3.9       | (23.0 )                        | (11.7 )   | 11.3      |
| Realized losses on available-for-sale securities   | 1.0                             | 0.9       | (0.1 )    | 3.3                            | 13.0      | 9.7       |
| Realized gains on investment in the Reserve Fund   | -                               | (14.8 )   | (14.8 )   | (0.9 )                         | (15.2 )   | (14.3 )   |
| Impairment losses on available-for-sale securities | -                               | -         | -         | -                              | 5.3       | 5.3       |
| Impairment losses on assets held for sale          | -                               | -         | -         | 8.6                            | -         | (8.6 )    |



Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|                            |          |          |          |          |          |         |
|----------------------------|----------|----------|----------|----------|----------|---------|
| Gain on sales of buildings | -        | -        | -        | (1.8)    | (1.5)    | 0.3     |
| Other, net                 | (0.6)    | (0.6)    | -        | (1.7)    | (1.7)    | -       |
| Other income, net          | \$(15.0) | \$(26.6) | \$(11.6) | \$(84.3) | \$(90.0) | \$(5.7) |

Other income, net decreased \$11.6 million for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 due to the change in the gain the Company realized on the Primary Fund of the Reserve Fund (the "Reserve Fund") of \$14.8 million during the three months ended March 31, 2010. This decrease was partially offset by an increase in realized gains on available-for-sale securities of \$3.9 million.

Other income, net decreased \$5.7 million for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010 due to the change in the gain the Company realized on the Reserve Fund during the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010, which reduced other income, net by \$14.3 million. Additionally, other income, net decreased due to an \$8.6 million impairment loss on assets held for sale recorded during the nine months ended March 31, 2011 and a \$9.4 million decrease in interest income on corporate funds due to lower average interest rates and a decrease in average daily balances. Average interest rates earned decreased from 2.7% for the nine months ended March 31, 2010 to 2.6% for the nine months ended March 31, 2011. Average daily balances decreased from \$3.9 billion for the nine months ended March 31, 2010 to \$3.5 billion for the nine months ended March 31, 2011. Such decreases in other income, net were partially offset by an increase in realized gains on available-for-sale securities and a decrease in realized losses on available-for-sale securities, which together increased other income, net by \$21.0 million. Other income, net for the nine months ended March 31, 2010 also included a \$5.3 million impairment loss on available-for-sale securities.

#### Earnings from Continuing Operations before Income Taxes

Earnings from continuing operations before income taxes increased \$20.0 million, or 3%, from \$633.0 million for the three months ended March 31, 2010 to \$653.0 million for the three months ended March 31, 2011 due to the increase in revenues, partially offset by the increase in expenses discussed above. Overall margin decreased from 26% for the three months ended March 31, 2010 to 24% for the three months ended March 31, 2011, with approximately 100 basis points of the margin decline coming from acquisitions.

Earnings from continuing operations before income taxes increased \$16.3 million, or 1%, from \$1,557.7 million for the nine months ended March 31, 2010 to \$1,574.0 million for the nine months ended March 31, 2011 due to the increase in revenues, partially offset by the increase in expenses discussed above. Overall margin decreased from 23% for the nine months ended March 31, 2010 to 21% for the nine months ended March 31, 2011, with approximately 90 basis points of the margin decline coming from acquisitions.

#### Provision for Income Taxes

The effective tax rate for the three months ended March 31, 2011 and 2010 was 35.1% and 36.6%, respectively. When compared to the effective tax rate for the three months ended March 31, 2010, the reduction in the effective tax rate for the three months ended March 31, 2011 is attributable to a decrease in federal and state income tax expense and a favorable mix of earnings in foreign jurisdictions.

The effective tax rate for the nine months ended March 31, 2011 and 2010 was 35.7% and 35.8%, respectively. The reduction in the effective tax rate for the nine months ended March 31, 2011 is due to the resolution of certain tax matters in the nine month period ended March 31, 2010 that resulted in a decrease to the effective tax rate of 0.8 percentage points for that period, offset by a decrease in federal and state income tax expense and a favorable mix of earnings in foreign jurisdictions for the nine months ended March 31, 2011.

#### Net Earnings from Continuing Operations and Diluted Earnings per Share from Continuing Operations

Net earnings from continuing operations increased \$22.2 million to \$423.8 million for the three months ended March 31, 2011 compared to \$401.6 million for the three months ended March 31, 2010, and diluted earnings per share from continuing operations increased from \$0.79 for the three months ended March 31, 2010 to \$0.85 for the three months ended March 31, 2011.

Net earnings from continuing operations increased \$12.7 million to \$1,012.4 million for the nine months ended March 31, 2011 compared to \$999.7 million for the nine months ended March 31, 2010, and diluted earnings per share from continuing operations increased from \$1.98 for the nine months ended March 31, 2010 to \$2.03 for the nine months ended March 31, 2011.

---

## Analysis of Reportable Segments

|                      | Three Months Ended |           | Revenues |    |                   |           |           |         |        |        |
|----------------------|--------------------|-----------|----------|----|-------------------|-----------|-----------|---------|--------|--------|
|                      | March 31,          |           |          |    | Nine Months Ended |           |           |         |        |        |
|                      | 2011               | 2010      | \$       | %  | 2011              | 2010      | \$        | %       | Change | Change |
| Employer Services    | \$1,925.1          | \$1,768.8 | \$156.3  | 9  | %                 | \$5,147.3 | \$4,801.0 | \$346.3 | 7      | %      |
| PEO Services         | 447.8              | 378.5     | 69.3     | 18 | %                 | 1,147.3   | 985.9     | 161.4   | 16     | %      |
| Dealer Services      | 391.5              | 304.5     | 87.0     | 29 | %                 | 1,103.2   | 904.6     | 198.6   | 22     | %      |
| Other                | 3.7                | 5.4       | (1.7 )   |    |                   | 10.0      | 14.4      | (4.4 )  |        |        |
| Reconciling items:   |                    |           |          |    |                   |           |           |         |        |        |
| Foreign exchange     | 48.1               | 41.0      | 7.1      |    |                   | 107.8     | 124.8     | (17.0 ) |        |        |
| Client fund interest | (78.9 )            | (55.0 )   | (23.9 )  |    |                   | (143.2 )  | (93.3 )   | (49.9 ) |        |        |
| Total                | \$2,737.3          | \$2,443.2 | \$294.1  | 12 | %                 | \$7,372.4 | \$6,737.4 | \$635.0 | 9      | %      |

|                        | Three Months Ended |         | Earnings from Continuing Operations before Income taxes |    |                   |           |           |         |        |        |
|------------------------|--------------------|---------|---|----|-------------------|-----------|-----------|---------|--------|--------|
|                        | March 31,          |         |   |    | Nine Months Ended |           |           |         |        |        |
|                        | 2011               | 2010    | \$  | %  | 2011              | 2010      | \$        | %       | Change | Change |
| Employer Services      | \$646.9            | \$600.2 | \$46.7  | 8  | %                 | \$1,455.1 | \$1,384.7 | \$70.4  | 5      | %      |
| PEO Services           | 37.8               | 30.0    | 7.8   | 26 | %                 | 102.0     | 97.9      | 4.1     | 4      | %      |
| Dealer Services        | 67.5               | 58.6    | 8.9   | 15 | %                 | 175.8     | 157.0     | 18.8    | 12     | %      |
| Other                  | (58.5 )            | (33.9 ) | (24.6 )   |    |                   | (110.2 )  | (81.9 )   | (28.3 ) |        |        |
| Reconciling items:     |                    |         |   |    |                   |           |           |         |        |        |
| Foreign exchange       | 8.9                | 7.4     | 1.5   |    |                   | 11.8      | 14.6      | (2.8 )  |        |        |
| Client fund interest   | (78.9 )            | (55.0 ) | (23.9 )   |    |                   | (143.2 )  | (93.3 )   | (49.9 ) |        |        |
| Cost of capital charge | 29.3               | 25.7    | 3.6   |    |                   | 82.7      | 78.7      | 4.0     |        |        |
| Total                  | \$653.0            | \$633.0 | \$20.0  | 3  | %                 | \$1,574.0 | \$1,557.7 | \$16.3  | 1      | %      |

The prior year's reportable segment revenues and earnings from continuing operations before income taxes have been adjusted to reflect updated budgeted foreign exchange rates for the fiscal year ending June 30, 2011. This adjustment is made for management purposes so that the reportable segments' results are presented on a consistent basis without the impact of fluctuations in foreign currency rates. This adjustment is a reconciling item to revenues and earnings from continuing operations before income taxes and results in the elimination of this adjustment in consolidation.

In addition, the reconciling items include an adjustment for the difference between actual interest income earned on invested funds held for clients and interest credited to Employer Services and PEO Services at a standard rate of 4.5%. This allocation is made for management reasons so that the reportable segments' results are presented on a consistent basis without the impact of fluctuations in interest rates. This allocation is a reconciling item to our reportable segments' revenues and earnings from continuing operations before income taxes and results in the elimination of this allocation in consolidation.

The reportable segments' results also include a cost of capital charge related to the funding of acquisitions and other investments. This charge is a reconciling item to earnings from continuing operations before income taxes and results in the elimination of this charge in consolidation.

## Employer Services

### Revenues

Employer Services' revenues increased \$156.3 million, or 9%, to \$1,925.1 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Revenues for our Employer Services business would have increased approximately 7% without the impact of recently completed acquisitions.

Revenues from our payroll and tax filing businesses increased 5% for the three months ended March 31, 2011 due to higher average client fund balances, improved worldwide client retention and an increase in pays per control in the U.S. We credit Employer Services with interest on client funds at a standard rate of 4.5%; therefore, Employer Services' results are not influenced by changes in interest rates. Interest on client funds recorded within the Employer Services segment increased \$24.5 million for the three months ended March 31, 2011 due to the increase in average client fund balances from \$18.2 billion for the three months ended March 31, 2010 to \$20.4 billion for the three months ended March 31, 2011. Our worldwide client retention rate increased by 1.9 percentage points for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010. Pays per control, which represents the number of employees on our clients' payrolls as measured on a same-store-sales basis utilizing a subset of over 126,000 payrolls of small to large businesses that are reflective of a broad range of U.S. geographic regions, increased 2.7% for the three months ended March 31, 2011. Revenues from our "beyond payroll" services increased 15% for the three months ended March 31, 2011 due to an increase in the number of clients utilizing our HR Benefits and Compliance solutions, as well as due to acquisitions.

Employer Services' revenues increased \$346.3 million, or 7%, to \$5,147.3 million for the nine months ended March 31, 2011 compared to the nine months ended March 31, 2010. Revenues for our Employer Services business would have increased approximately 5% without the impact of recently completed acquisitions.

Revenues from our payroll and tax filing businesses increased 2% for the nine months ended March 31, 2011 due to higher average client fund balances, improved worldwide client retention and an increase in pays per control in the U.S., partially offset by timing of certain revenues related to calendar year-end activities. We credit Employer Services with interest on client funds at a standard rate of 4.5%; therefore, Employer Services' results are not influenced by changes in interest rates. Interest on client funds recorded within the Employer Services segment increased \$50.4 million for the nine months ended March 31, 2011 due to the increase in average client fund balances from \$14.6 billion for the nine months ended March 31, 2010 to \$16.1 billion for the nine months ended March 31, 2011. Our worldwide client retention rate increased by 1.5 percentage points for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010. Pays per control, which represents the number of employees on our clients' payrolls as measured on a same-store-sales basis utilizing a subset of over 126,000 payrolls of small to large businesses that are reflective of a broad range of U.S. geographic regions, increased 2.3% for the nine months ended March 31, 2011. Revenues from our "beyond payroll" services increased 14% for the nine months ended March 31, 2011 due to an increase in the number of clients utilizing our HR Benefits, Compliance and Retirement Services solutions, as well as due to acquisitions.

### Earnings from Continuing Operations before Income Taxes

Earnings from continuing operations before income taxes increased \$46.7 million, or 8%, to \$646.9 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increase was due to the increase in revenues of \$156.3 million discussed above, which was partially offset by an increase in expenses of \$109.6 million. In addition to an increase in expenses related to increased revenues, expenses increased for the three

months ended March 31, 2011 due to increases in sales and service headcount over prior year levels. Overall margin decreased from 33.9% to 33.6% for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010, which includes approximately 90 basis points of the margin decline coming from acquisitions.

Earnings from continuing operations before income taxes increased \$70.4 million, or 5%, to \$1,455.1 million for the nine months ended March 31, 2011 compared to the nine months ended March 31, 2010. The increase was due to the increase in revenues of \$346.3 million discussed above, which was partially offset by an increase in expenses of \$275.9 million. In addition to an increase in expenses related to increased revenues, expenses increased for the nine months ended March 31, 2011 due to increases in sales and service headcount over prior year levels. Overall margin decreased from 28.8% to 28.3% for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010, which includes approximately 50 basis points of the margin decline coming from acquisitions.

#### PEO Services

##### Revenues

PEO Services' revenues increased \$69.3 million, or 18%, to \$447.8 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 due to a 13% increase in the average number of worksite employees. The increase in the average number of worksite employees as compared to the prior year was due to an increase in the number of new clients and growth in our existing clients. Revenues associated with benefits coverage, workers' compensation coverage and state unemployment taxes for worksite employees that were billed to our clients increased \$55.1 million due to the increase in the average number of worksite employees, as well as increases in health care costs. Administrative revenues, which represent the fees for our services and are billed based upon a percentage of wages related to worksite employees, increased \$9.3 million for the three months ended March 31, 2011 due to the increase in the average number of worksite employees.

We credit PEO Services with interest on client funds at a standard rate of 4.5%; therefore, PEO Services' results are not influenced by changes in interest rates. Interest on client funds recorded within the PEO Services segment increased \$0.1 million for the three months ended March 31, 2011, due to the increase in average client funds balances as a result of increased PEO Services new business and growth in our existing client base. Average client funds balances were \$0.2 billion for the three months ended March 31, 2011 and were \$0.2 billion for the three months ended March 31, 2010.

PEO Services' revenues increased \$161.4 million, or 16%, to \$1,147.3 million for the nine months ended March 31, 2011 compared to the nine months ended March 31, 2010 due to an 11% increase in the average number of worksite employees. The increase in the average number of worksite employees as compared to the prior year was due to an increase in the number of new clients and growth in our existing clients. Revenues associated with benefits coverage, workers' compensation coverage and state unemployment taxes for worksite employees that were billed to our clients increased \$131.8 million due to the increase in the average number of worksite employees, as well as increases in health care costs. Administrative revenues increased \$21.2 million for the nine months ended March 31, 2011 due to the increase in the average number of worksite employees.

We credit PEO Services with interest on client funds at a standard rate of 4.5%; therefore, PEO Services' results are not influenced by changes in interest rates. Interest on client funds recorded within the PEO Services segment increased \$0.4 million for the nine months ended March 31, 2011, due to the increase in average client funds balances as a result of increased PEO Services new business and growth in our existing client base. Average client funds balances were \$0.2 billion for the nine months ended March 31, 2011 and were \$0.2 billion for the nine months ended March 31, 2010.

##### Earnings from Continuing Operations before Income Taxes

Earnings from continuing operations before income taxes increased \$7.8 million, or 26%, to \$37.8 million for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010. Earnings from continuing operations before income taxes increased due to growth in earnings related to an increase in the number of average worksite employees.

Earnings from continuing operations before income taxes increased \$4.1 million, or 4%, to \$102.0 million for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010. Earnings from continuing operations before income taxes increased due to growth in earnings related to an increase in the number of average worksite employees. The increase was partially offset by the settlement of a state unemployment tax matter, which increased earnings before income taxes by \$9.2 million during the nine months ended March 31, 2010.

#### Dealer Services

##### Revenues

Dealer Services' revenues increased \$87.0 million, or 29%, to \$391.5 million for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010. Revenues for our Dealer Services business would have increased approximately 3% for the three months ended March 31, 2011 without the impact of recently completed acquisitions, which increased revenues by \$77.0 million. Revenues increased by \$10.0 million due to new clients and growth in our key products during the three months ended March 31, 2011 as compared to the three months ended March 31, 2010. The growth in our key products was driven by increased users for Application Service Provider ("ASP") managed services and growth in hosted IP telephony, as well as an increase in transaction revenues due to higher credit checks and vehicle registrations.

Dealer Services' revenues increased \$198.6 million, or 22%, to \$1,103.2 million for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010. Revenues for our Dealer Services business would have increased approximately 3% for the nine months ended March 31, 2011 without the impact of recently completed acquisitions, which increased revenues by \$174.1 million. Revenues increased by \$24.5 million due to new clients and growth in our key products during the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010. The growth in our key products was driven by increased users for ASP managed services and growth in hosted IP telephony, as well as an increase in transaction revenues due to higher credit checks and vehicle registrations.

##### Earnings from Continuing Operations before Income Taxes

Dealer Services' earnings from continuing operations before income taxes increased \$8.9 million, or 15%, to \$67.5 million for the three months ended March 31, 2011 as compared to the three months ended March 31, 2010 due to the revenue increases described above, partially offset by higher compensation costs and acquisition costs.

Dealer Services' earnings from continuing operations before income taxes increased \$18.8 million, or 12%, to \$175.8 million for the nine months ended March 31, 2011 as compared to the nine months ended March 31, 2010 due to the revenue increases described above, partially offset by higher compensation costs and acquisition costs. Earnings from continuing operations before income taxes also increased due to an asset impairment charge of \$6.8 million during the three months ended September 30, 2009 as a result of the announcement by General Motors Company that it will shut down its Saturn division.

#### FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2011, cash and marketable securities were \$1,741.1 million, stockholders' equity was \$6,194.5 million and the ratio of long-term debt-to-equity was 0.6%. Working capital before funds held for clients and client funds obligations was \$1,672.7 million at March 31, 2011 compared to \$1,568.6 million at June 30, 2010. This increase is

due to cash generated from operations of \$1,220.3 million, partially offset by the use of cash to pay dividends of \$513.2 million, contributions to our pension plans of \$156.5 million, and repurchases of common stock of \$174.8 million.

Net cash flows provided by operating activities were \$1,220.3 million for the nine months ended March 31, 2011 compared to \$1,286.6 million for the comparable period in the prior fiscal year. The decrease in net cash flows provided by operating activities was due to an increase in bonus payments of \$47.0 million, an increase in pension plan contributions of \$46.3 million and an increase in foreign tax payments of \$14.3 million, offset by \$123.4 million in tax refunds received during the nine months ended March 31, 2011. The balance of the decrease was due to timing of cash collections related to trade accounts receivable, partially offset by the timing of cash payments related to accounts payable.

Net cash flows used in investing activities were \$14,634.8 million for the nine months ended March 31, 2011, as compared to net cash flows used in investing activities of \$10,081.3 million for the comparable period in the prior fiscal year. The increase in net cash flows used in investing activities was due to the timing of purchases of and proceeds from the sales or maturities of marketable securities which resulted in a net decrease to cash flows of \$1,213.0 million, the increase of spend relating to acquisitions of businesses, net of cash acquired, which resulted in a net decrease to cash flows of \$675.8 million and the increase in restricted cash and cash equivalents held to satisfy client funds obligations which resulted in a net decrease to cash flows of \$2,634.7 million.

Net cash flows provided by financing activities were \$13,335.8 million for the nine months ended March 31, 2011 compared to net cash flows provided by financing activities of \$8,492.4 million for the comparable period in the prior fiscal year. The increase was due to the net change in client funds obligations of \$3,883.9 million as a result of timing of cash received and payments made related to client funds and a \$730.0 million decrease in repayments of previously issued commercial paper and a \$104.4 million decrease in cash used for repurchases of common stock. We purchased approximately 3.8 million shares of our common stock at an average price per share of \$45.71 during the nine months ended March 31, 2011 compared to purchases of 6.5 million shares of our common stock at an average price per share \$42.68 during the nine months ended March 31, 2010.

Our U.S. short-term funding requirements related to client funds are sometimes obtained through a short-term commercial paper program, which provides for the issuance of up to \$6.25 billion in aggregate maturity value of commercial paper. Our commercial paper program is rated A-1+ by Standard and Poor's and Prime-1 by Moody's. These ratings denote the highest quality commercial paper securities. Maturities of commercial paper can range from overnight to up to 364 days. At March 31, 2011 and June 30, 2010, there was no commercial paper outstanding. For the three months ended March 31, 2011 and 2010, we had average borrowings of \$0.6 billion and \$0.6 billion, respectively, at a weighted average interest rate of 0.2% for both periods. For the nine months ended March 31, 2011 and 2010, the Company's average borrowings were \$1.7 billion and \$1.8 billion, respectively, at a weighted average interest rate of 0.2% for both periods. The weighted average maturity of our commercial paper during each of the three and nine months ended March 31, 2011 and 2010 was less than two days. Throughout the nine month period ended March 31, 2011 we had full access to our U.S. short term funding requirements related to client funds obligations.

Our U.S. and Canadian short-term funding requirements related to client funds obligations are sometimes obtained on a secured basis through the use of reverse repurchase agreements, which are collateralized principally by government and government agency securities. These agreements generally have terms ranging from overnight to up to five business days. We have \$2 billion available to us on a committed basis under these reverse repurchase agreements. At March 31, 2011 and June 30, 2010, respectively, we had no outstanding obligations under reverse repurchase agreements. For the three months ended March 31, 2011 and 2010, we had average outstanding balances under reverse repurchase agreements of \$160.3 million and \$109.0 million, respectively, at weighted average interest rates of 0.8% and 0.2%, respectively. For the nine months ended March 31, 2011 and 2010, the Company had average outstanding balances under reverse repurchase agreements of \$439.0 million and \$367.8 million, respectively, at

weighted average interest rates of 0.5% and 0.2%, respectively. We have successfully borrowed through the use of reverse repurchase agreements on an as needed basis to meet short-term funding requirements related to client fund obligations.

The Company has a \$2.5 billion, 364-day credit agreement with a group of lenders that matures in June 2011. In addition, the Company has a three-year \$1.5 billion credit facility maturing in June 2013 that contains an accordion feature under which the aggregate commitment can be increased by \$500.0 million, subject to the availability of additional commitments. The Company also has a \$2.25 billion five-year credit facility that matures in June 2011 that also contains an accordion feature under which the aggregate commitment can be increased by \$500.0 million, subject to the availability of additional commitments. The interest rate applicable to the committed borrowings is tied to LIBOR, the federal funds effective rate or the prime rate depending on the notification provided by the Company to the syndicated financial institutions prior to borrowing. The Company is also required to pay facility fees on the credit agreements. The primary uses of the credit facilities are to provide liquidity to the commercial paper program and to provide funding for general corporate purposes, if necessary. The Company had no borrowings through March 31, 2011 under the credit agreements. We believe that we currently meet all conditions set forth in the revolving credit agreements to borrow thereunder, and we are not aware of any conditions that would prevent us from borrowing part or all of the \$6.25 billion available to us under the revolving credit agreements.

Our investment portfolio does not contain any asset-backed securities with underlying collateral of sub-prime mortgages, alternative-A mortgages, sub-prime auto loans or sub-prime home equity loans, collateralized debt obligations, collateralized loan obligations, credit default swaps, asset-backed commercial paper, derivatives, auction rate securities, structured investment vehicles or non-investment-grade fixed-income securities. We own AAA rated senior tranches of fixed rate credit card, rate reduction, auto loan and other asset-backed securities, secured predominately by prime collateral. All collateral on asset-backed securities is performing as expected. In addition, we own senior debt directly issued by Federal Home Loan Banks, Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac"). We do not own subordinated debt, preferred stock or common stock of any of these agencies. We do own AAA rated mortgage-backed securities, which represent an undivided beneficial ownership interest in a group or pool of one or more residential mortgages. These securities are collateralized by the cash flows of 15-year and 30-year residential mortgages and are guaranteed by Fannie Mae and Freddie Mac as to the timely payment of principal and interest. Our client funds investment strategy is structured to allow us to average our way through an interest rate cycle by laddering the maturities of our investments out to five years (in the case of the extended portfolio) and out to ten years (in the case of the long portfolio). This investment strategy is supported by our short-term financing arrangements necessary to satisfy short-term funding requirement relating to client funds obligations.

For the nine months ended March 31, 2011, capital expenditures for continuing operations were \$122.1 million. Capital expenditures for continuing operations for the fiscal year ending June 30, 2011 are expected to be between \$160.0 million and \$180.0 million compared to \$90.2 million in the fiscal year ended June 30, 2010.

In the normal course of business, we enter into contracts in which we make representations and warranties that relate to the performance of our products and services. We do not expect any material losses related to such representations and warranties.

#### Quantitative and Qualitative Disclosures about Market Risk

Our overall investment portfolio is comprised of corporate investments (cash and cash equivalents, short-term marketable securities, and long-term marketable securities) and client funds assets (funds that have been collected from clients but not yet remitted to the applicable tax authorities or client employees).

Our corporate investments are invested in cash and cash equivalents and highly liquid, investment-grade marketable securities. These assets are available for repurchases of common stock for treasury and/or acquisitions, as well as



other corporate operating purposes. All of our short-term and long-term fixed-income securities are classified as available-for-sale securities.

Our client funds assets are invested with safety of principal, liquidity, and diversification as the primary goals. Consistent with those goals, we also seek to maximize interest income and to minimize the volatility of interest income. Client funds assets are invested in highly liquid, investment-grade marketable securities with a maximum maturity of 10 years at the time of purchase and money market securities and other cash equivalents. At March 31, 2011, approximately 79% of the available-for-sale securities categorized as U.S. Treasury and direct obligations of U.S. government agencies were invested in senior, unsecured, non-callable debt directly issued by the Federal Home Loan Banks, Fannie Mae and Freddie Mac.

We utilize a strategy by which we extend the maturities of our investment portfolio for funds held for clients and employ short-term financing arrangements to satisfy our short-term funding requirements related to client funds obligations. Our client funds investment strategy is structured to allow us to average our way through an interest rate cycle by laddering the maturities of our investments out to five years (in the case of the extended portfolio) and out to ten years (in the case of the long portfolio). As part of our client funds investment strategy, we use the daily collection of funds from our clients to satisfy other unrelated client fund obligations, rather than liquidating previously-collected client funds that have already been invested in available-for-sale securities. We minimize the risk of not having funds collected from a client available at the time such client's obligation becomes due by impounding, in virtually all instances, the client's funds in advance of the timing of payment of such client's obligation. As a result of this practice, we have consistently maintained the required level of client fund assets to satisfy all of our client funds obligations.

There are inherent risk and uncertainties involving our investment strategy relating to our client fund assets. Such risks include liquidity risk, including the risk associated with our ability to liquidate, if necessary, our available-for-sale securities in a timely manner in order to satisfy our client funds obligations. However, our investments are made with the safety of principal, liquidity and diversification as the primary goals to minimize the risk of not having sufficient funds to satisfy all of our client funds obligations. We also believe we have significantly reduced the risk of not having sufficient funds to satisfy our client funds obligations by consistently maintaining access to other sources of liquidity, including our corporate cash balances, available borrowings under our \$6.25 billion commercial paper program (rated A-1+ by Standard and Poor's and Prime-1 by Moody's, the highest possible credit rating), our ability to execute reverse repurchase transactions (\$2 billion of which is available on a committed basis) and available borrowings under our \$6.25 billion committed revolving credit facilities. However, the availability of financing during periods of economic turmoil, even to borrowers with the highest credit ratings, may limit our flexibility to access short-term debt markets to meet the liquidity needs of our business. In addition to liquidity risk, our investments are subject to interest rate risk and credit risk, as discussed below.

We have established credit quality, maturity, and exposure limits for our investments. The minimum allowed credit rating at time of purchase for corporate bonds is BBB and for asset-backed and commercial mortgage-backed securities is AAA. The maximum maturity at time of purchase for BBB rated securities is 5 years, for single A rated securities is 7 years, and for AA rated and AAA rated securities is 10 years. Commercial paper must be rated A1/P1 and, for time deposits, banks must have a Financial Strength Rating of C or better.

Details regarding our overall investment portfolio are as follows:

|                                      | Three Months Ended |           | Nine Months Ended |           |
|--------------------------------------|--------------------|-----------|-------------------|-----------|
|                                      | March 31,          |           | March 31,         |           |
|                                      | 2011               | 2010      | 2011              | 2010      |
| Average investment balances at cost: |                    |           |                   |           |
| Corporate investments                | \$2,177.1          | \$2,659.3 | \$3,472.5         | \$3,852.7 |

Edgar Filing: AUTOMATIC DATA PROCESSING INC - Form 10-Q

|                        |                   |                   |                   |                   |
|------------------------|-------------------|-------------------|-------------------|-------------------|
| Funds held for clients | 20,629.5          | 18,424.7          | 16,336.0          | 14,816.3          |
| <b>Total</b>           | <b>\$22,806.6</b> | <b>\$21,084.0</b> | <b>\$19,808.5</b> | <b>\$18,669.0</b> |

Average interest rates earned

|  |     |   |     |   |     |   |     |   |
|--|-----|---|-----|---|-----|---|-----|---|
| exclusive of realized gains/(losses) on: |     |   |     |   |     |   |     |   |
| Corporate investments                    | 1.8 | % | 1.6 | % | 2.6 | % | 2.7 | % |
| Funds held for clients                   | 2.9 | % | 3.2 | % | 3.3 | % | 3.6 | % |
| Total                                    | 2.8 | % | 3.0 | % | 3.2 | % | 3.4 | % |

|  |        |        |        |          |
|--|--------|--------|--------|----------|
| Realized gains on available-for-sale securities              | \$5.4  | \$1.5  | \$23.0 | \$11.7   |
| Realized losses on available-for-sale securities             | (1.0 ) | (0.9 ) | (3.3 ) | (13.0 )  |
| Net realized gains/(losses) on available-for-sale securities | \$4.4  | \$0.6  | \$19.7 | \$(1.3 ) |

|   |                   |                  |
|---|-------------------|------------------|
|   | March 31,<br>2011 | June 30,<br>2010 |
| Net unrealized pre-tax gains on available-for-sale securities | \$466.5           | \$710.9          |
| Total available-for-sale securities at fair value             | \$16,670.3        | \$15,517.0       |

Our laddering strategy exposes us to interest rate risk in relation to securities that mature, as the proceeds from maturing securities are reinvested. Factors that influence the earnings impact of the interest rate changes include, among others, the amount of invested funds and the overall portfolio mix between short-term and long-term investments. This mix varies during the fiscal year and is impacted by daily interest rate changes. The annualized interest rates earned on our entire portfolio decreased by 20 basis points, from 3.0% for the three months ended March 31, 2010 to 2.8% for the three months ended March 31, 2011 and decreased by 20 basis points, from 3.4% for the nine months ended March 31, 2010 to 3.2% for the nine months ended March 31, 2011. A hypothetical change in both short-term interest rates (e.g., overnight interest rates or the federal funds rate) and intermediate-term interest rates of 25 basis points applied to the estimated average investment balances and any related short-term borrowings would result in approximately a \$9 million impact to earnings before income taxes over the ensuing twelve-month period ending March 31, 2012. A hypothetical change in only short-term interest rates of 25 basis points applied to the estimated average short-term investment balances and any related short-term borrowings would result in approximately a \$4 million impact to earnings before income taxes over the ensuing twelve-month period ending March 31, 2012.

We are exposed to credit risk in connection with our available-for-sale securities through the possible inability of the borrowers to meet the terms of the securities. We limit credit risk by investing in investment-grade securities, primarily AAA and AA rated securities, as rated by Moody's, Standard & Poor's, and for Canadian securities, Dominion Bond Rating Service. At March 31, 2011, approximately 87% of our available-for-sale securities held a AAA or AA rating. In addition, we limit amounts that can be invested in any security other than US and Canadian government or government agency securities.

We had no derivative financial instruments outstanding at March 31, 2011 or June 30, 2010.

New Accounting Pronouncements

On July 1, 2010, we adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2009-13, "Multiple Deliverable Revenue Arrangements," and ASU 2009-14, "Certain Revenue Arrangements that

Include Software Elements.” ASU 2009-13 modifies the guidance related to accounting for arrangements with multiple deliverables by providing an alternative when vendor specific objective evidence (“VSOE”) or third-party evidence (“TPE”) does not exist to determine the selling price of a deliverable. The alternative when VSOE or TPE does not exist is management’s best estimate of the selling price of the deliverable. Consideration for multiple deliverables is then allocated based upon the relative selling price of the deliverables and revenue is recognized as earned for each deliverable. ASU 2009-14 modifies the scope of the software revenue recognition guidance to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product’s functionality. The adoption of ASU 2009-13 and ASU 2009-14 did not have a material impact on our consolidated results of operations, financial condition or cash flows.

In December 2010, we adopted ASU 2010-20, “Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses.” ASU 2010-20 requires greater transparency about a company’s allowance for credit losses and the credit quality of its financing receivables. The guidance is intended to provide disclosures to help facilitate the evaluation of the Company’s credit risk, how that risk is analyzed and the reasons for changes in the allowance for credit losses. The adoption of ASU 2010-20 did not have an impact on our consolidated results of operations, financial condition or cash flows.

In December 2010, the FASB issued ASU 2010-29, "Disclosure of Supplementary Pro Forma Information for Business Combinations." ASU 2010-29 requires an entity to disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. ASU 2010-29 is effective prospectively for business combinations that occur on or after the beginning of the first annual reporting period beginning after December 15, 2010. We do not expect that the adoption of ASU 2010-29 will have an impact on our consolidated results of operations, financial condition or cash flows.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The information called for by this item is provided under the caption "Quantitative and Qualitative Disclosures about Market Risk" under Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Item 4. Controls and Procedures.

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the "evaluation"). Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2011 in ensuring that (i) information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and (ii) such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no changes in the Company's internal control over financial reporting that occurred during the three months ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, the

Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

Except as noted below, all other items are either inapplicable or would result in negative responses and, therefore, have been omitted.

### Item 1. Legal Proceedings.

In the normal course of business, the Company is subject to various claims and litigation. While the outcome of any litigation is inherently unpredictable, the Company believes it has valid defenses with respect to the legal matters pending against it and the Company believes that the ultimate resolution of these matters will not have a material adverse impact on its financial condition, results of operations or cash flows.

### Item 1A. Risk Factors.

There have been no material changes in our risk factors disclosed in Part 1, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

## Issuer Purchases of Equity Securities

| Period                                   | (a)<br>Total<br>Number<br>of Shares<br>Purchased<br>(1) | (b)<br>Average<br>Price<br>Paid per<br>Share | (c)<br>Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>the<br>Publicly<br>Announced<br>Common<br>Stock<br>Repurchase<br>Plan (2) | (d)<br>Maximum<br>Number<br>of Shares<br>that<br>may yet be<br>Purchased<br>under<br>the<br>Common<br>Stock<br>Repurchase<br>Plan (2) |
|--|---|--|---|---|
| January 1, 2011<br>to January 31, 2011   | 11,035  | \$46.28                                      | -   | 26,404,051  |
| February 1, 2011<br>to February 28, 2011 | 231   | \$43.67                                      | -   | 26,404,051  |
| March 1, 2011<br>to March 31, 2011       | 1,852,263   | \$50.18                                      | 1,444,600   | 24,959,451  |
| <b>Total</b>                             | <b>1,863,529</b>  |  | <b>1,444,600</b>  |   |

(1) During the three months ended March 31, 2011, pursuant to the terms of the Company's restricted stock program, the Company made repurchases of 418,929 shares, at the then market value of the shares in connection with the exercise by employees of their option under such program to satisfy certain tax withholding requirements through the delivery of shares to the Company instead of cash.

(2) The Company received the Board of Directors' approval to repurchase shares of our common stock as follows:

| Date of Approval | Shares     |
|------------------|------------|
| March 2001       | 50 million |
| November 2002    | 35 million |
| November 2005    | 50 million |
| August 2006      | 50 million |
| August 2008      | 50 million |

There is no expiration date for the common stock repurchase plan.



Item 6. Exhibits.

| Exhibit Number | Exhibit  |
|----------------|--|
| 31.1           | Certification by Gary C. Butler pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934  |
| 31.2           | Certification by Christopher R. Reidy pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934  |
| 32.1           | Certification by Gary C. Butler pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002       |
| 32.2           | Certification by Christopher R. Reidy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS*       | XBRL instance document   |
| 101.SCH*       | XBRL taxonomy extension schema document  |
| 101.CAL*       | XBRL taxonomy extension calculation linkbase document  |
| 101.LAB*       | XBRL taxonomy label linkbase document  |
| 101.PRE*       | XBRL taxonomy extension presentation linkbase document   |
| 101.DEF*       | XBRL taxonomy extension definition linkbase document   |

\*As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AUTOMATIC DATA PROCESSING, INC.  
(Registrant)

Date: May 6, 2011

/s/ Christopher R. Reidy  
Christopher R. Reidy

Chief Financial Officer  
(Title)

