

Review of ADP's FY2026

Automatic Data Processing, Inc.

NASDAQ: ADP

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Summary

ADP's results for FY2026 leave its competitive position intact. None of the monitorables set in the investment memorandum of 22 May 2026 triggered a reassessment, and management's guidance for FY2027 does not imply that any will. Management's commentary on AI is compatible with ADP participating and enabling the industry transformation as opposed to being disrupted by it. The valuation is revised to reflect structural improvements in operating cash conversion, the FY2026 client fund balance, and a higher risk free-rate. As of this report's date, the probability weighted value is 213.18 USD per share. At the current market price of 258.06, the stock trades at a premium of 21% relative to this value. ADP is a recommended buy below 171 USD per share.

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1. Monitorables

The investment memorandum set the following thresholds for reassessment. Each is scored against the results for FY2026 and the guidance for FY2027 (ADP, Earnings Release FY2026, p. 1-4).

Monitorable	Threshold	FY2026 outcome	FY2027 guidance	Status
ES pays per control	Negative growth	1% growth	0-1% growth	Not triggered
ES new business growth	Negative growth	6% growth	4-7% growth	Not triggered
ES client retention	At or below 90%	92.1%	- 10-30 basis points	Not triggered
PEO average worksite employee growth	Negative growth	2% growth	Approximately 2%	Not triggered
PEO revenue per worksite employee	Negative growth	Increased (Table B)	PEO revenue 5-7% growth	Not triggered
Leverage	Monitored for creditworthiness	Reduced (Table B)	Not guided	Not triggered
FCF conversion	Four consecutive quarters of improvement		Not guided	Not triggered

Notes: ES = Employer Services.

None of the thresholds was crossed in FY2026, and the guidance for FY2027 does not imply that any will be. New business booking growth of 6% in FY2026 shows strength in ADP's solution offerings and distribution capabilities. Return on incremental invested capital was positive in both FY2025 and FY2026 over both the three year and the five year window against primarily negative values in the investment memorandum (Table B). This suggests that ADP is finding profitable investments in its operations. As of FY2026 there is no sign of disruption hurting ADP operationally or financially.

2. Business Development and Competitive Position

The investment memorandum identified AI as a source of disruption for the industry both by lowering barriers to entry and through agentic AI as a substitute for parts of ADP's offerings. Management frames AI differently in its commentary on FY2026. According to management, AI is reshaping how work is done, what roles look like and how teams are organised instead of eliminating jobs at scale. Additionally, employers face a growing wave of regulation and compliance requirements as they increase their use of AI (ADP, Earnings Call FY2026, p. 3). This makes human capital management more critical as employers redesign their workforce (ADP, Earnings Press Release FY2026, p. 1). The operational data in section 1 and this narrative are compatible with ADP participating in the transformation of work as opposed to being disrupted by it.

The investment memorandum noted that ADP is deploying AI both internally and in its client offerings. Since launching ADP Assist agents in January 2026, ADO has made them available to nearly all of its more than 1.1 million clients across payroll, benefits, HR, and compliance. In FY2026, 3.1 million unique active users had 12 million conversations with ADP Assist, and since January 2026 it has delivered 45 000 compliance insights that let clients act on tax and regulatory issues before they become problems (ADP, Earnings Call FY2026, p. 3). ADP Assist is also available on the ADP Marketplace, where clients connect ADP's solutions to their own technology and ADP APIs (ADP, Earnings Call FY2026, p. 4). This adds to the investment memorandum's discussion of agentic AI as a substitute since ADP is building agents into the client workflow it already serves instead of only facing them from competitors.

In the enterprise market, where the investment memorandum identified Workday as a competitor, the number of live clients on ADP Lyric HCM increased by 94% YoY though from an undisclosed base. The Lyric pipeline grew 50%, with new logos representing 70% of these opportunities. ADP also made progress in international sales. New business bookings also showed strength in international business, global payroll, and global HR. These segments mainly serve enterprise clients. Management described a large global auto manufacturer expanding its relationship with ADP during an AI driven workforce transformation across 13 countries. It involves new workforce structures, new compensation frameworks, and country specific labor law, payroll, and reporting requirements (ADP, Earnings Call FY2026, p. 4).

Small businesses also performed well in FY2026 (ADP, Earnings Call FY2026, p. 3), but the momentum appears strongest at the enterprise level. The investment memorandum found that embedded payroll infrastructure and agentic AI mainly target smaller businesses currently. As competition for smaller business increases, ADP needs to avoid neglecting that segment and losing its presence there.

The investment memorandum argued that rising regulation favours incumbents with scale, and management's commentary supports this. According to management, the regulatory

landscape is fragmented by country, state, city, and municipality. ADP's scale becomes more valuable as work becomes more complex since ADP already makes workforce management manageable across more than 140 countries, territories, and numerous local jurisdictions (ADP, Earnings Call FY2026, p. 5). This increases the stickiness of the client relationship.

The investment memorandum identified data, talent, legacy, and scale as ADP's competitive advantages. Management named data, domain expertise, distribution, and trust as its structural advantages (ADP, Earnings Call FY2026, p. 15). On data, ADP pays 42 million wage earners globally, including one in six wage earners in the U.S. Through a research partnership with the Stanford Digital Economy Lab, ADP breaks work down into tasks and measures how the pay for each task changes over time, which management says no other HCM company can match (ADP, Earnings Call FY2026, p. 4-5). On distribution, ADP has 9 000 sellers and an ecosystem of CPAs, banks, brokers, and system integrators. Management highlights trust, solutions built with a long history, and through its approach to responsible AI as the most important advantages at present (ADP, Earnings Call FY2026, p. 15). Trust relates closely to the legacy identified in the investment memorandum, while distribution was not named there as a separate advantage.

According to management, AI contributes to sales productivity, lower call volumes, and efficiency, and thereby to bookings, retention, and EBIT. ADP monetizes AI partly through discrete charges, such as consumption based pricing for API calls on its marketplace and API Central, and partly through a value based pricing method where it charges for incremental features and functionality (ADP, Earnings Call FY2026, p. 12). Pricing is therefore becoming more based on value in use. This cuts both ways because it makes it harder for clients to compare ADP with alternatives but clients may also not fully understand what they pay for. Data, distribution, and trust support for ADP's ability to price on value, though monitorables related to pricing remain important to track closely.

Taken together, the commentary supports the view that ADP is enabling the transformation of work instead of falling victim to it. It also nuances the industry discussion in the investment memorandum. While AI lowers barriers to entry, it also makes workforce management and compliance more complex, which favours a provider with ADP's scale, data, and reach.

3. Management and Incentives

Against its initial guidance for FY2026, ADP delivered revenue growth within the guided range, and beat the guidance for adjusted EBIT margin expansion and adjusted diluted EPS growth (Table C). Hence, management's credibility remains intact as of the investment memorandum. Furthermore, the 2026 proxy statement (ADP, 2026) shows no material change in the compensation of executive directors and non-executive directors in FY2026 with FY2025. The mix across compensation elements, the performance measures, and the targets are similar to the prior year, which preserves the incentive to run the company in the interest of shareholders.

4. Valuation

The valuation follows the investment memorandum with four changes:

- 1) Operating cash conversion: Free cash flow conversion from operations now uses the median of the last three fiscal years (i.e., FY2024 to FY2026) instead of the median since FY2018. A median over the full period would remove structural changes of the business, and thus give a faulty estimate of the intrinsic value. The client fund conversion is left unchanged.
- 2) Client fund balance: The average balance of client funds is updated from FY2025 to FY2026.
- 3) Discount rate: The 10 year U.S. Treasury par yield was 5.29% on 30 September 2026 (YCharts, 2026). With beta and the equity risk premium unchanged, the cost of equity rises from 8.30% to 9.03% and WACC from 8.04% to 8.74%.

In addition, the bear case probability is lowered from 10% to 5% and the base case probability raised from 80% to 85% with the best case unchanged at 10%. ADP's strategic development in the competitive arena, especially with AI as discussed in section 2, makes the bear case less likely.

Scenario	Value per share (USD)	Probability
Bear case	52.55	5%
Base case	215.53	85%
Best case	273.49	10%
<i>Probability weighted</i>	<i>213.18</i>	

The probability weighted value is 213.18 USD per share, up 14% from 186.94 USD in the investment memorandum. The base case value is 215.53 per share, up 13.6% from 189.77 USD. Over the same period the share price rose 14.5% from 225.31 USD on 22 May 2026 to 258.06 USD on 30 September 2026. At 258.06 USD the stock trades at a premium of 21% relative to the probability weighted value. The bear case value of 52.55 USD per share implies a decline 79.6% from the current price (Table H).

5. Conclusion

FY2026 leaves ADP's competitive position unchanged. The thresholds set in the investment memorandum held, management's guidance and incentives remain credible, and the commentary on AI is consistent with AP participating in and enabling the industry transformation. The revised valuation raises the probability weighted value to 213.18 USD per share, but the share price has risen by a similar amount. Hence, the stock still trades at a premium. Applying the margin of 25%, following the investment memorandum, gives a buy price of 170.54 USD per share. Accordingly, the following is advised, assuming no stock splits or similar events:

- Buy below 171 USD per share
- Hold between 171 and 216 USD per share
- Avoid above 216 USD per share

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