AUTOMATIC DATA PROCESSING INC
Form 10-Q
May 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 31, 2007

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	**22-1467904**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
One ADP Boulevard, Roseland, New Jersey	**07068**
(Address of principal executive offices)	(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 [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

The number of shares outstanding of the registrant's common stock as of April 30, 2007 was 553,238,164.

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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 March 31, 2007	Three Months Ended March 31, 2006	Nine Months Ended March 31, 2007	Nine Months Ended March 31, 2006
REVENUES:				
Revenues, other than interest on funds held for Employer Services' clients and PEO revenues	$ 1,741.9	$ 1,563.2	$ 4,729.5	$ 4,211.7
Interest on funds held for Employer Services' clients	198.3	166.2	475.3	393.5
PEO revenues (A)	249.1	197.6	649.5	516.9
TOTAL REVENUES	2,189.3	1,927.0	5,854.3	5,122.1
EXPENSES:				
Costs of revenues				
Operating expenses	899.4	781.8	2,536.8	2,160.5
Systems development and programming costs	122.2	120.5	355.7	343.2
Depreciation and amortization	54.0	42.3	155.8	122.9
TOTAL COST OF REVENUES	1,075.6	944.6	3,048.3	2,626.6
Selling, general and administrative expenses	554.1	495.3	1,570.5	1,376.4
Interest expense	7.0	7.0	74.8	51.3
Other income, net	(25.2)	(23.0)	(175.4)	(78.6)
TOTAL EXPENSES	1,611.5	1,423.9	4,518.2	3,975.7
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	577.8	503.1	1,336.1	1,146.4
Provision for income taxes	213.5	188.5	495.7	430.1
NET EARNINGS FROM CONTINUING OPERATIONS	$ 364.3	$ 314.6	$ 840.4	$ 716.3
Earnings from discontinued operations, net of provision for income taxes of $51.4 and $35.0 for the three months ended March 31, 2007 and 2006, respectively, and $96.9 and $84.5 for the nine months ended March 31, 2007 and 2006, respectively	24.6	56.0	103.6	134.0
NET EARNINGS	$ 388.9	$ 370.6	$ 944.0	$ 850.3
Basic Earnings Per Share from Continuing Operations	$ 0.66	$ 0.54	$ 1.52	$ 1.24
Basic Earnings Per Share from Discontinued Operations	0.04	0.10	0.19	0.23
BASIC EARNINGS PER SHARE	$ 0.70	$ 0.64	$ 1.71	$ 1.47

Diluted Earnings Per Share from Continuing Operations	$	0.65	$	0.54	$	1.51	$	1.23
Diluted Earnings Per Share from Discontinued Operations		0.04		0.10		0.19		0.23
DILUTED EARNINGS PER SHARE	$	0.70	$	0.64	$	1.69	$	1.46
Basic weighted average shares outstanding		552.1		577.5		551.6		577.0
Diluted weighted average shares outstanding		558.7		582.8		558.5		582.7
Dividends declared per common share	$	0.2300	$	0.1850	$	0.6450	$	0.5250

(A) Professional Employer Organization (“PEO”) revenues are net of direct pass-through costs of $2,417.8 and $1,957.6 for the three months ended March 31, 2007 and 2006, respectively, and $6,763.1 and $5,167.5 for the nine months ended March 31, 2007 and 2006, respectively.

See notes to the consolidated financial statements

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

Assets	March 31, 2007	June 30, 2006
Current assets:		
Cash and cash equivalents	$ 2,473.5	$ 1,867.3
Short-term marketable securities	207.8	327.5
Accounts receivable, net	915.0	765.0
Other current assets	455.5	400.4
Assets of discontinued operations	4.6	2,122.0
Total current assets	4,056.4	5,482.2
Long-term marketable securities	105.9	333.7
Long-term receivables, net	205.1	215.4
Property, plant and equipment, net	710.1	701.5
Other assets	840.1	772.3
Goodwill	2,317.5	1,985.8
Intangible assets, net	717.0	515.3
Total assets before funds held for clients	8,952.1	10,006.2
Funds held for clients	23,970.8	17,483.9
Total assets	$ 32,922.9	$ 27,490.1
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 105.9	$ 127.2
Accrued expenses and other current liabilities	1,413.5	1,373.9
Income taxes payable	220.3	202.2
Liabilities of discontinued operations	25.6	967.5
Total current liabilities	1,765.3	2,670.8
Long-term debt	43.6	74.3
Other liabilities	396.6	361.6
Deferred income taxes	190.5	103.0
Deferred revenues	479.9	481.4
Total liabilities before client funds obligations	2,875.9	3,691.1
Client funds obligations	24,058.3	17,787.4
Total liabilities	26,934.2	21,478.5
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	63.9	63.9
Capital in excess of par value	315.7	157.4
Retained earnings	9,220.2	9,111.4
Treasury stock - at cost: 83.7 and 77.3 shares, respectively	(3,636.5)	(3,194.8)

Accumulated other comprehensive income (loss)	25.4	(126.3)
Total stockholders’ equity	5,988.7	6,011.6
Total liabilities and stockholders’ equity	$ 32,922.9	$ 27,490.1

See notes to the consolidated financial statements.

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

	Nine Months Ended March 31,	
	2007	2006
Cash Flows from Operating Activities:		
Net earnings	$ 944.0	$ 850.3
Adjustments to reconcile net earnings to cash flows provided by operating activities:		
Gain on sale of cost-based investment	(38.6)	-
Depreciation and amortization	214.4	181.9
Deferred income taxes	(16.1)	(61.7)
Stock-based compensation expense	103.9	106.6
Pension expense	30.4	23.5
Net realized (gain) loss from the sales of marketable securities	(17.3)	16.8
Amortization of premiums and discounts on available-for-sale securities	31.3	60.8
Gain on sale of business	(24.4)	-
Impairment of assets of discontinued operations businesses	-	18.6
Other	27.1	35.8
Changes in operating assets and liabilities, net of effects from acquisitions and divestitures of businesses:		
Increase in receivables and other assets	(207.4)	(46.6)
(Decrease) increase in accounts payable, accrued expenses and other liabilities	(9.0)	(11.5)
Operating activities of discontinued operations	73.7	299.6
Net cash flows provided by operating activities	1,112.0	1,474.1
Cash Flows from Investing Activities:		
Purchases of marketable securities	(3,347.7)	(4,164.9)
Proceeds from the sales and maturities of marketable securities	3,513.6	3,325.6
Net purchases of client funds securities	(6,065.1)	(3,787.7)
Change in client funds obligations	6,225.4	4,756.6
Capital expenditures	(122.6)	(189.6)
Additions to intangibles	(138.4)	(73.4)
Proceeds from the sale of investment	38.6	-
Proceeds from the sale of business, net of cash divested	17.2	6.2
Acquisitions of businesses, net of cash acquired	(433.0)	(335.5)
Dividend received from Broadridge Financial Solutions, Inc.	690.0	-
Cash retained by Broadridge Financial Solutions, Inc.	(29.9)	-
Other	16.3	12.9
Investing activities of discontinued operations	(28.2)	(56.1)
Net cash flows provided by (used in) investing activities	336.2	(505.9)
Cash Flows from Financing Activities:		
Proceeds from issuance of notes	0.4	0.4
Payments of debt	(1.6)	(0.5)
Repurchases of common stock	(906.3)	(545.2)
Proceeds from stock purchase plan and exercises of stock options	224.5	175.9

Dividends paid		(334.0)		(286.9)
Financing activities of discontinued operations		134.1		55.0
Net cash flows used in financing activities		(882.9)		(601.3)
Effect of exchange rate changes on cash and cash equivalents		7.5		(5.1)
Net change in cash and cash equivalents		572.8		361.8
Cash and cash equivalents, beginning of period		1,900.7		975.4
Cash and cash equivalents, end of period	$	2,473.5	$	1,337.2
Less cash and cash equivalents of discontinued operations, end of period		-		217.5
Cash and cash equivalents of continuing operations, end of period	$	2,473.5	$	1,119.7

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 unaudited consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods. Adjustments are of a normal recurring nature. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes of Automatic Data Processing, Inc. and Subsidiaries ("ADP" or the "Company") as of and for the year ended June 30, 2006. The results of operations for the three and nine months ended March 31, 2007 may not be indicative of the results to be expected for the fiscal year ending June 30, 2007.

Note 2. Discontinued Operations

On March 30, 2007 the Company completed the tax free spin-off of its former Brokerage Services Group business, comprised of Brokerage Services and Securities Clearing and Outsourcing Services, into an independent publicly traded company called Broadridge Financial Solutions, Inc. ("Broadridge"). As a result of the spin-off, ADP stockholders of record on March 23, 2007 (the "record date") received one share of Broadridge common stock, with a par value $0.01 per share, for every four shares of ADP common stock held by them on the record date and cash for any fractional shares of Broadridge common stock. ADP distributed approximately 138.8 million shares of Broadridge common stock in the distribution. The spin-off was made without the payment of any consideration or the exchange of any shares by ADP stockholders.

The Company has classified the results of operations of Broadridge as discontinued operations for all periods presented. Additionally, the Company recorded a decrease to retained earnings of $1.2 billion for the non-cash reduction in net assets of Broadridge related to the spin-off, offset by an increase to retained earnings of $690.0 million related to the cash dividend received from Broadridge as part of the spin-off. The spin-off and the transitional and on-going relationships between ADP and Broadridge are governed by a Separation and Distribution Agreement entered into between ADP and Broadridge, and certain other ancillary agreements.

Incremental costs associated with the spin-off of $25.0 million and $35.5 million for the three and nine months ended March 31, 2007, respectively, are included in earnings from discontinued operations on the Statements of Consolidated Earnings and are principally related to professional services. ADP expects to incur total incremental costs associated with the spin-off of approximately $40.0 million during fiscal 2007.

On January 23, 2007, the Company completed the sale of Sandy Corporation, a business within the Dealer Services segment, which specializes in sales and marketing training, for approximately $4.0 million in cash and the assumption of certain liabilities by the buyer, plus an additional earn-out payment if certain revenue targets are achieved. The Company reported a gain of $11.2 million, or $6.9 million after tax within earnings from discontinued operations on the Statements of Consolidated Earnings. The Company has classified the results of operations of this business as discontinued operations for all periods presented.

On April 13, 2006, the Company completed the sale of its Claims Services business to Solera, Inc. for $975.0 million in cash and reported a gain of $560.9 million, or $452.8 million after tax, during the fiscal year ended June 30, 2006. During the nine months ended March 31, 2007, the Company received an additional payment of $13.2 million, or $12.6 million after tax, from Solera, Inc., which represented the final purchase price adjustment for the sale of the Claims Services business. The Company reported the gain and the final purchase price adjustment within earnings from discontinued operations on the Statements of Consolidated Earnings. The Claims Services business was a separate operating segment of the Company and was reported in the "Other" segment. In connection with the disposal of this business, the Company has classified the results of operations of this business as discontinued operations for all periods presented.

On January 20, 2006, the Company completed the sale of its Brokerage Services' financial print business for $7.5 million in cash. The Company classified the results of operations of this business as discontinued operations during the fiscal year ended June 30, 2006. In connection with the plan to dispose of the financial print business, the Company recorded an impairment charge of $18.6 million in order to reflect the assets of this business at fair value during the three months ended December 31, 2005 in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This impairment charge is included in the earnings from discontinued operations on the Statements of Consolidated Earnings.

Operating results of these discontinued operations were as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Revenues	$ 558.5	$ 625.6	$ 1,444.9	$ 1,652.1
Earnings from discontinued operations before income taxes	64.8	91.0	176.1	218.5
Provision for income taxes	47.1	35.0	92.0	84.5
Net earnings from discontinued operations before gain on disposal of discontinued operations	17.7	56.0	84.1	134.0
Gain on disposal of discontinued operations, net of provision for income taxes of $4.3 for the three months ended March 31, 2007 and $4.9 for the nine months ended March 31, 2007	6.9	-	19.5	-
Net earnings from discontinued operations	$ 24.6	$ 56.0	$ 103.6	$ 134.0

The following are the major classes of assets and liabilities related to the discontinued operations as of March 31, 2007 and June 30, 2006.

	March 31, 2007	June 30, 2006
Assets:		
Cash	$ -	$ 33.4
Short-term marketable securities	-	40.3
Accounts receivable, net	4.6	437.3
Securities clearing receivables	-	836.8
Property, plant and equipment, net	-	80.9
Goodwill	-	480.4
Intangible assets, net	-	102.7
Other assets	-	110.2
Total	$ 4.6	$ 2,122.0
Liabilities:		
Accounts payable	$ -	$ 80.1
Accrued expenses	4.8	210.1
Securities clearing payables	-	613.6
Income taxes payable	20.8	18.1
Deferred revenue	-	45.6
Total	$ 25.6	$ 967.5

Note 3. Cost of Revenues

The Company has revised the format of our Statements of Consolidated Earnings to include a separate line item for cost of revenues. The Company’s costs and expenses applicable to revenues (“cost of revenues”) represent the total of operating expenses and systems development and programming costs as presented on the Statements of Consolidated Earnings, as well as the portion of depreciation and amortization that relates to our services and products.

The Company previously reported that depreciation and amortization from continuing operations totaled $61.9 million and $181.9 million for the three and nine months ended March 31, 2006, respectively. The portion of depreciation and amortization that relates to our services and products equals $42.3 million and $122.9 million for the three and nine months ended March 31, 2006, respectively, and is included in cost of revenues. The portion of depreciation and amortization that does not relate to our services and products of $19.6 million and $59.0 million for the three and nine months ended March 31, 2006, respectively, was reclassified to selling, general and administrative expenses on the Statements of Consolidated Earnings.

The following table provides the cost of revenues from continuing operations for the three fiscal years ended June 30, 2006:

Years ending June 30,	2006	2005	2004
Operating expenses	$ 2,997.9	$ 2,621.4	$ 2,271.5
Systems development and programming costs	472.6	426.9	402.8
Depreciation and amortization	166.0	156.1	159.6

Cost of revenues	$ 3,636.5	$ 3,204.4	$ 2,833.9

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Note 4. New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"). SFAS No. 159 provides companies with an option to measure selected financial assets and liabilities at fair value. The Company is currently evaluating the effect that the adoption of SFAS No. 159 will have, if any, on its consolidated results of operations and financial condition.

In September 2006, the staff of the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 requires companies to evaluate the materiality of identified unadjusted errors on each financial statement and related financial statement disclosure using both the rollover approach and the iron curtain approach. SAB 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The Company plans to include the effect of adopting SAB 108 in its Annual Report on Form 10-K for the year ending June 30, 2007 and currently estimates the adoption of SAB 108 to result in an increase to retained earnings of $40.0 million, net of tax, which will be primarily due to a reduction in certain accrued expenses.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS No. 158"). This statement would require a company to (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and (c) recognize changes in the funded status of a defined benefit plan in the year in which the changes occur (reported in comprehensive income). The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the first fiscal year ending after December 15, 2006. The Company plans to include the effect of adopting SFAS No. 158 in its Annual Report on Form 10-K for the year ending June 30, 2007. Based on the unrecognized actuarial losses of ADP's pension plans in its June 30, 2006 Annual Report on Form 10-K, we expect to reclassify $116 million, net of tax, from other assets to accumulated other comprehensive income on the Consolidated Balance Sheets upon the adoption of SFAS No. 158, which will result in a reduction of stockholders' equity. The Company will reevaluate this estimate upon adoption of SFAS No. 158, based upon its June 30, 2007 plan measurement date, which will likely impact the above-described amount. The requirement to measure the plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not believe that the adoption of SFAS No. 158 will have a material impact on the consolidated results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company believes that the adoption of SFAS No. 157 will not have a material effect on its consolidated results of operations, cash flows or financial condition.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 applies to all tax positions accounted for under SFAS No. 109, "Accounting for Income Taxes" and defines the confidence level that a tax position must meet in order to be recognized in the financial statements. The interpretation requires that the tax effects of a position be recognized only if it is "more-likely-than-not" to be sustained by the taxing authority as of the reporting date. If a tax position is not considered "more-likely-than-not" to be sustained then

no benefits of the position are to be recognized. FIN 48 requires additional annual disclosures and is effective as of the beginning of the first fiscal year beginning after December 15, 2006. The Company expects to adopt FIN 48 on July 1, 2007 and is currently evaluating the effect that the adoption of FIN 48 will have on its consolidated results of operations and financial condition.

Note 5. Acquisitions

The Company acquired 100% interest in nine businesses during the nine months ended March 31, 2007 for approximately $432.1 million, net of cash acquired and subject to post-closing purchase price adjustments. The Company has allocated the purchase price of these acquisitions based upon preliminary estimates and assumptions. Accordingly, these allocations are subject to revision when the Company receives final information, including appraisals and other analyses. These acquisitions resulted in approximately $304.5 million of goodwill. Intangible assets acquired, which totaled approximately $154.5 million, consisted primarily of customer contracts and lists, as well as software, that are being amortized over a weighted average life of approximately 10 years. The acquisitions were not material, either individually or in the aggregate, to the Company's operations, financial position or cash flows. The Company also made $0.9 million of contingent payments relating to previously consummated acquisitions.

Note 6. Earnings Per Share ("EPS")

	For the three months ended March 31,					
	2007			2006		
	Net Earnings from Continuing Operations	Weighted Average Shares	EPS from Continuing Operations	Net Earnings from Continuing Operations	Weighted Average Shares	EPS from Continuing Operations
Basic	$ 364.3	552.1	$ 0.66	$ 314.6	577.5	$ 0.54
Effect of zero coupon subordinated notes	0.3	0.9		0.2	1.1	
Effect of employee compensation related shares	-	5.7		-	4.2	
Diluted	$ 364.6	558.7	$ 0.65	$ 314.8	582.8	$ 0.54

	For the nine months ended March 31,					
	2007			2006		
	Net Earnings from Continuing Operations	Weighted Average Shares	EPS from Continuing Operations	Net Earnings from Continuing Operations	Weighted Average Shares	EPS from Continuing Operations
Basic	$ 840.4	551.6	$ 1.52	$ 716.3	577.0	$ 1.24
Effect of zero coupon subordinated notes	1.1	1.0		0.8	1.2	
Effect of employee compensation related shares	-	5.9		-	4.5	

Diluted	$	841.5	558.5	$	1.51	$	717.1	582.7	$	1.23

Options to purchase 13.0 million and 35.8 million shares of common stock for the three months ended March 31, 2007 and 2006, respectively, and 19.0 million and 28.4 million shares of common stock for the nine months ended March 31, 2007 and 2006, respectively, were excluded from the

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calculation of diluted earnings per share, as the effect would have been anti-dilutive for each respective period.

Note 7. Fair Value Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with SFAS No. 123R, "Share-Based Payment" ("SFAS No. 123R"), which requires the measurement of stock-based compensation expense to be recognized 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, generally vest ratably over five 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. In fiscal 2007, the Company has reduced the number of stock options issued to employees and replaced these awards with the issuance of performance-based restricted stock.
- Employee Stock Purchase Plan. Prior to November 2005, the Company offered an employee stock purchase plan that allowed eligible employees to purchase shares of common stock at 85% of the lower of market value as of the date the purchase price for an offering was determined or as of the end of such offering. In November 2005, the Company revised the employee stock purchase plan offering beginning on January 1, 2006, whereby eligible employees can purchase shares of common stock at 85% of the market value at the date the purchase price for the offering is determined. Compensation expense for the employee stock purchase plan is recognized over the vesting period of 24 months on a straight-line basis.
- Restricted Stock. The Company has a restricted stock program under which shares of common stock have been issued 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 over the period during which the transfer restrictions exist, which is up to five years from the date of grant. The value of the Company's restricted stock, based on market prices, is recognized as compensation expense over the restriction period on a straight-line basis.

The Company currently utilizes treasury stock to satisfy stock option exercises, issuances under its employee stock purchase plan and restricted stock awards. Stock-based compensation expense of $33.4 million and $35.6 million was recognized in earnings from continuing operations for the three months ended March 31, 2007 and 2006, respectively, as well as related tax benefits of $10.2 million and $10.6 million, respectively. Stock-based compensation expense of $103.9 million and $106.6 million was recognized in earnings from continuing operations for the nine months ended March 31, 2007 and 2006, respectively, as well as related tax benefits of $31.1 million and $30.7 million, respectively.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Operating expenses	$ 6.3	$ 5.7	$ 18.0	$ 18.2
Selling, general and administrative expenses	21.3	24.2	68.1	70.6
System development and programming costs	5.8	5.7	17.8	17.8
Total pretax stock-based compensation expense included in continuing operations	$ 33.4	$ 35.6	$ 103.9	$ 106.6
Total pretax stock-based compensation expense included in discontinued operations	5.5	8.0	17.9	25.4
Total pretax stock-based compensation expense	$ 38.9	$ 43.6	$ 121.8	$ 132.0

As of March 31, 2007, the total remaining unrecognized compensation cost from continuing operations related to non-vested stock options, the employee stock purchase plan and restricted stock awards amounted to $84.5 million, $25.8 million and $78.7 million, respectively, which will be amortized over the weighted average periods of 1.2 years, 0.9 years and 1.1 years, respectively.

As a result of the spin-off of Broadridge, the number of vested and unvested ADP stock options, as well as the strike price on these options, and the number of shares elected under the outstanding employee stock purchase plan, as well as the purchase price for these offerings, was adjusted to preserve the intrinsic value of the awards immediately prior to the spin-off using an adjustment ratio based on the ADP closing market stock price prior to the spin-off and the ADP opening market stock price subsequent to the spin-off. Additionally, the "targeted" number of performance-based restricted shares, which will convert to actual restricted shares at the end of their performance period in fiscal 2009, were adjusted to preserve the intrinsic value of the performance-based restricted awards immediately prior to the spin-off similar to the stock options and employee stock purchase plan awards noted above. As the adjustments were considered modifications of awards in accordance with SFAS No.123R, the Company compared the fair value of the awards immediately prior to the spin-off to the fair value immediately after the spin-off to measure the incremental stock-based compensation cost. The adjustments did not result in an increase in the fair value of the awards and, accordingly, the Company did not record incremental stock-based compensation expense. ADP stock options and restricted stock awards held by Broadridge employees were cancelled or forfeited as of the date of the spin-off. The stock-based compensation expense associated with the original grant of ADP stock to continuing ADP employees will continue to be recognized within earnings from continuing operations on the Company's Statements of Consolidated Earnings. The stock-based compensation expense related to Broadridge employees for services received through March 30, 2007 are reflected in earnings from discontinued operations on the Statements of Consolidated Earnings.

A summary of changes in outstanding stock options for the nine months ended March 31, 2007 is as follows:

	Number of Options (a) (in thousands)	Weighted Average Price (a) (in dollars)
Options outstanding at July 1, 2006	73,189	$ 49
Options granted	3,289	$ 43
Options exercised	(8,933)	$ 34
Options canceled (b)	(10,573)	$ 41
Options outstanding at March 31, 2007	56,972	$ 40

(a) The number of options and weighted average price were adjusted to reflect the impact of the spin-off of Broadridge.

(b) Includes 7.8 million of options held by Broadridge employees that were cancelled or forfeited as of the date of spin-off.

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 following assumptions were used to determine the fair values estimated at the date of grant of stock options granted during the nine months ended March 31, 2007 and 2006:

Risk-free interest rate	4.7% - 5.0%	4.0% - 4.6%
Dividend yield	1.6% - 1.7%	1.4% - 1.7%
Weighted average volatility factor	18.4% - 24.7%	17.1% - 24.7%
Weighted average expected life (in years)		
Stock options	4.9 – 5.6	5.5 – 5.6
Stock purchase plan	2.0	2.0
Weighted average fair value (in dollars)		
Stock options	$11.82	$10.89
Stock purchase plan	$12.34	$9.76

Note 8. Other Income, net

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Interest income on corporate funds	$ (25.7)	$ (23.8)	$ (119.5)	$ (95.4)
Gain on sale of investment	-	-	(38.6)	-
Realized gains on available-for-sale securities	(0.4)	(0.2)	(20.5)	(0.8)
Realized losses on available-for-sale securities	0.9	1.0	3.2	17.6
Other income, net	$ (25.2)	$ (23.0)	$ (175.4)	$ (78.6)

During the nine months ended March 31, 2007, the Company sold a minority investment that was previously accounted for using the cost basis and had a net book value of $0. The Company’s sale of this investment resulted in a gain of $38.6 million.

Note 9. Comprehensive Income

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Net earnings	$ 388.9	$ 370.6	$ 944.0	$ 850.3
Other comprehensive income (loss):				
Foreign currency translation adjustments	(23.8)	15.0	8.1	(1.4)
Unrealized net gain (loss) on available-for-sale securities, net of tax	32.5	(54.5)	143.6	(164.0)
Comprehensive income	$ 397.6	$ 331.1	$ 1,095.7	$ 684.9

Note 10. Interim Financial Data by Segment

Employer Services and Dealer Services are the Company's reportable segments. The primary components of “Other” are miscellaneous processing services and corporate allocations and expenses, including stock-based compensation expense.

The Company evaluates the performance of its reportable segments based on operating results before interest on corporate funds, foreign currency gains and losses and income taxes. 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’s reportable segment revenues and earnings from continuing operations before income taxes have been adjusted to reflect updated fiscal 2007 budgeted foreign exchange rates.

Reconciling items include foreign exchange differences between the actual foreign exchange rates and fiscal 2007 budgeted foreign exchange rates, and the adjustment for the difference between actual interest income earned on invested funds held for Employer Services’ clients and interest credited to Employer Services at a standard rate of 4.5%. Both of these adjustments are eliminated in consolidation and as such represent reconciling items to revenues and earnings from continuing

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operations before income taxes. The reportable segment results also include an internal cost of capital charge related to the funding of acquisitions and other investments. This charge is eliminated in consolidation and as such represents a reconciling item to earnings from continuing operations before income taxes.

Segment Results:

	Revenues			
	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Employer Services	$ 1,860.0	$ 1,656.7	$ 4,854.2	$ 4,336.4
Dealer Services	310.6	286.6	908.0	780.1
Other	(5.7)	(1.2)	50.0	62.0
Reconciling items:				
Foreign exchange	20.6	(1.7)	50.3	(6.7)
Client fund interest	3.8	(13.4)	(8.2)	(49.7)
Total	$ 2,189.3	$ 1,927.0	$ 5,854.3	$ 5,122.1

	Earnings From Continuing Operations Before Income Taxes			
	Three Months Ended March 31,		Nine Months Ended March 31,	
	2007	2006	2007	2006
Employer Services	$ 556.0	$ 503.8	$ 1,186.6	$ 1,085.8
Dealer Services	51.2	37.5	143.5	117.5
Other	(66.0)	(51.6)	(77.2)	(81.8)
Reconciling items:				
Foreign exchange	2.6	0.2	5.8	(0.7)
Client fund interest	3.8	(13.4)	(8.2)	(49.7)
Cost of capital charge	30.2	26.6	85.6	75.3
Total	$ 577.8	$ 503.1	$ 1,336.1	$ 1,146.4

Note 11. Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients at March 31, 2007 and June 30, 2006 are as follows:

	March 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Type of issue:				
Money market securities and other cash equivalents	$ 13,162.3	-	-	$ 13,162.3
Available-for-sale securities:				
U.S. Treasury and direct obligations of U.S. government agencies	6,172.4	3.8	(62.1)	6,114.1
Asset backed securities	1,991.8	6.2	(12.3)	1,985.7
Corporate bonds	3,734.7	11.9	(24.6)	3,722.0
Canadian government obligations and Canadian government agency obligations	971.8	0.2	(7.4)	964.6
Other securities	813.9	2.0	(6.6)	809.3
Total available-for-sale securities	13,684.6	24.1	(113.0)	13,595.7
Total corporate investments and funds held for clients	$ 26,846.9	$ 24.1	$ (113.0)	$ 26,758.0

	June 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Type of issue:				
Money market securities and other cash equivalents	$ 6,399.6	-	-	$ 6,399.6
Available-for-sale securities:				
U.S. Treasury and direct obligations of U.S. government agencies	6,441.5	0.1	(165.0)	6,276.6
Asset backed securities	2,214.1	0.3	(40.8)	2,173.6
Corporate bonds	3,564.7	0.2	(75.9)	3,489.0
Canadian government obligations and Canadian government agency obligations	838.1	0.1	(11.5)	826.7
Other securities	867.3	0.1	(20.5)	846.9
Total available-for-sale securities	13,925.7	0.8	(313.7)	13,612.8
Total corporate investments and funds held for clients	$ 20,325.3	$ 0.8	$ (313.7)	$ 20,012.4

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

	March 31, 2007	June 30, 2006
Corporate investments:		
Cash and cash equivalents	$ 2,473.5	$ 1,867.3
Short-term marketable securities	207.8	327.5
Long-term marketable securities	105.9	333.7
Total corporate investments	2,787.2	2,528.5
Funds held for clients	23,970.8	17,483.9
Total corporate investments and funds held for clients	$ 26,758.0	$ 20,012.4

The Company believes that its available-for-sale securities that have fair values below cost are not other-than-temporarily impaired since it is probable that principal and interest would be collected in accordance with contractual terms, and that the decline in the market value was due to changes in interest rates and not changes to credit risk. The Company currently believes that it has the ability to hold these investments until the earlier of market price recovery and/or maturity and currently intends to do so. The Company's assessment that an investment is not other-than-temporarily impaired could change in the future due to new developments or changes in the Company's strategies or assumptions related to any particular investment.

At March 31, 2007 approximately 95% of the available-for-sale securities held an AAA or AA rating, as rated by Moody's, Standard & Poor's and, for Canadian securities, Dominion Bond Rating Service.

Expected maturities of available-for-sale securities at March 31, 2007 are as follows:

Due in one year or less	$ 2,594.9
Due after one year to two years	2,742.9
Due after two years to three years	2,729.1
Due after three years to four years	2,475.0
Due after four years to ten years	3,053.8
Total available-for-sale securities	$ 13,595.7

Note 12. Allowance for Doubtful Accounts

The allowance for doubtful accounts was $44.6 million and $40.0 million at March 31, 2007 and June 30, 2006, respectively.

Note 13. Goodwill and Intangible Assets, net

Changes in goodwill for the nine months ended March 31, 2007 are as follows:

	Employer Services	Dealer Services	Other	Total
Balance as of June 30, 2006	$ 1,246.2	$ 730.0	$ 9.6	$ 1,985.8
Additions and other adjustments, net	294.7	12.3	-	307.0
Currency translation adjustments	10.8	13.6	0.3	24.7
Balance as of March 31, 2007	$ 1,551.7	$ 755.9	$ 9.9	$ 2,317.5

Components of intangible assets, net are as follows:

	March 31, 2007	June 30, 2006
Intangible assets:		
Software and software licenses	$ 933.4	$ 642.2
Customer contracts and lists	725.6	582.1
Other intangibles	246.2	243.2
	1,905.2	1,467.5
Less accumulated amortization:		
Software and software licenses	(670.1)	(474.1)
Customer contracts and lists	(347.0)	(313.9)
Other intangibles	(171.1)	(164.2)
	(1,188.2)	(952.2)
Intangible assets, net	$ 717.0	$ 515.3

Other intangibles consist primarily of purchased rights, covenants, 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 (3 years for software and software licenses, 11 years for customer contracts and lists, and 11 years for other). Amortization of intangibles totaled $37.5 million and $29.2 million for the three months ended March 31, 2007 and 2006, respectively, and totaled $106.3 million and $85.4 million for the nine months ended March 31, 2007 and 2006, respectively. Estimated amortization expense of the Company's existing intangible assets for the remaining three months of fiscal 2007 and the succeeding five fiscal years are as follows:

	Amount
2007	$ 49.9
2008	$ 158.5
2009	$ 115.7
2010	$ 88.8
2011	$ 56.5
2012	$ 45.7

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Note 14. Short-term Financing

In June 2006, the Company entered into a $1.75 billion, 364-day credit agreement and a $2.25 billion, five-year credit agreement with a group of lenders. The five-year facility contains an accordion feature under which the aggregate commitment can be increased by $500.0 million to $2.75 billion, subject to the availability of additional commitments. These facilities replaced the Company's prior $1.25 billion, 364-day facility, and $2.25 billion, five-year facility, both of which were terminated in June 2006. The $1.75 billion and $2.25 billion agreements mature in June 2007 and June 2011, respectively. The Company also has a $1.5 billion credit facility that matures in June 2010. The interest rate applicable to the borrowings is tied to LIBOR or 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, 2007 under the credit agreements.

The Company maintains a U.S. short-term commercial paper program providing for the issuance of up to $5.5 billion in aggregate maturity value of commercial paper at the Company's discretion. 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 270 days. At March 31, 2007 and 2006, there was no commercial paper outstanding. For both the three months ended March 31, 2007 and 2006, the Company had average borrowings of $0.4 billion at a weighted average interest rate of 5.3% and 4.4%, respectively. For the nine months ended March 31, 2007 and 2006, the Company had average borrowings of $1.6 billion and $1.4 billion, respectively, at a weighted average interest rate of 5.3% and 3.8%, respectively. The weighted average maturity of the Company's commercial paper during the three and nine months ended March 31, 2007 and 2006 was less than two days for each period.

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 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. At March 31, 2007 and 2006, there were no outstanding obligations under repurchase agreements. For the three months ended March 31, 2007 and 2006, the Company had average outstanding balances under repurchase agreements of $59.8 million and $83.8 million, respectively, at a weighted average interest rate of 4.2% and 3.4%, respectively. For the nine months ended March 31, 2007 and 2006, the Company had average outstanding balances under repurchase agreements of $105.6 million and $169.6 million, respectively, at a weighted average interest rate of 4.4% and 3.2%, respectively.

Note 15. Debt

In February 2007, the Company exercised its call option and notified holders of its zero coupon convertible subordinated notes that the Company would redeem all the notes that were outstanding as of the end of the business day on March 19, 2007 (the "redemption date"). Prior to the redemption date, approximately $39 million in face value of the notes was converted into approximately 1 million shares of the Company's common stock. The Company subsequently redeemed the remaining 352 notes outstanding as of the redemption date at a redemption price of $775 for each note, representing the accrued value of each note at the time of the redemption.

Note 16. Pension Plans

The components of net pension expense were as follows:

	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Service cost– benefits earned during the period	$ 10.8	$ 7.9	$ 32.5	$ 23.7
Interest cost on projected benefits	12.1	9.9	36.3	29.6
Expected return on plan assets	(15.3)	(14.0)	(45.8)	(41.9)
Net amortization and deferral	3.7	4.8	10.9	14.4
Net pension expense	$ 11.3	$ 8.6	$ 33.9	$ 25.8

Net pension expense for the three months ended March 31, 2007 and 2006 includes $1.2 million and $0.8 million, respectively, reported within earnings from discontinued operations on the Statements of Consolidated Earnings. Net pension expense for the nine months ended March 31, 2007 and 2006 includes $3.5 million and $2.3 million, respectively, reported within earnings from discontinued operations on the Statements of Consolidated Earnings.

The minimum required contribution to the Company’s pension plans is $3.3 million in fiscal 2007. For the nine months ended March 31, 2007, the Company made $22.5 million in contributions to the pension plans and expects to contribute an additional $0.8 million during fiscal 2007.

Note 17. Commitments and Contingencies

The Company is subject to various 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.

It is not the Company’s business practice to enter into off-balance sheet arrangements. However, the Company is exposed to market risk from changes in foreign currency exchange rates that could impact its financial position, results of operations and 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. 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 products and services.

Note 18. Income Taxes

The Company is routinely examined by the IRS and tax authorities in countries in which it conducts business, as well as in states in which it has significant business operations. The tax years under examination vary by jurisdiction. The Company expects an IRS examination for fiscal 1998 through fiscal 2002 to be substantially completed during fiscal 2008. In addition, the IRS is conducting an examination of fiscal 2003 through fiscal 2006. The Company regularly considers the likelihood of assessments in each of the jurisdictions resulting from examinations. The Company has established tax reserves which it believes are adequate in relation to the potential assessments. Once established, reserves are adjusted when there is more information available, when an event occurs necessitating a

change to the reserves or when the statute of limitations for the relevant taxing authority to examine the tax position has expired. The resolution of tax matters should not have a material effect on the consolidated financial condition of the Company, although a resolution could have a material impact on the Company's Statements of Consolidated Earnings for a particular future period and on the Company's effective tax rate.

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

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

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying