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ADP.OQ - Q4 2024 Automatic Data Processing Inc Earnings Call

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## OVERVIEW:

Company Summary

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**Don Edward McGuire** *Automatic Data Processing Inc - CFO*

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## PRESENTATION

### Operator

Good morning. My name is Michelle and I'll be your conference operator. At this time, I would like to welcome everyone to ADP's fourth quarter 2024 earnings call. I would like to inform you that this conference is being recorded.

(Operator Instructions) I will now turn the conference over to Matt Keating, Vice President of Investor Relations. Please go ahead.

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### Matthew Keating - *Automatic Data Processing Inc - VP of Investor Relations*

Thank you, Michelle, and welcome, everyone to ADP's Fourth Quarter Fiscal 2024 Earnings Call. Participating today are Maria Black, our President and CEO; and Don McGuire, our CFO.

Earlier this morning, we released our results for the quarter. Our earnings materials are available on the SEC's website and our Investor Relations website at [investors.adp.com](https://investors.adp.com), where you also find the Investor Presentation that accompanies today's call.

During our call, we will reference non-GAAP financial measures, which we believe to be useful to investors and that exclude the impact of certain items. The description of these items, along with a reconciliation of non-GAAP measures to the most comparable GAAP measures, can be found in our earnings release.

Today's call will contain forward-looking statements that refer to future events and involve some risk. We encourage you to review our filings with the SEC for additional information on factors that could cause actual results to differ materially from current expectations.

I'll now turn it over to Maria.

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Thank you, Matt and good morning. Before we get started, I'd like to take a minute to thank Danyal Hussain for leading Investor Relations for these past several years. He helped lead us through the pandemic and helped shepherd our CFO and CEO transitions during his time. With Danny moving on to a broader role, it is my pleasure to officially welcome Matt Keating to his first call. Congratulations to you both.

We closed out the year with a strong fourth quarter that included 6% revenue growth, 80 basis points of adjusted EBIT margin expansion and 11% adjusted EPS growth. For fiscal 2024, we delivered 7% revenue growth, 70 basis points of adjusted EBIT margin expansion, and 12% adjusted EPS growth, representing another great year for ADP. I'm excited to share the progress we've made across our three strategic priorities, but first, I'll start off with some additional highlights from our results.

Our sales and marketing team delivered exceptional employer services, new business bookings in Q4, on top of a strong Q4 last year. This performance was broad based, showing continued strength in our small business portfolio, as well as our mid-market enterprise and international businesses. In fact, we sold and started more than 50,000 new small business clients during the quarter, which not only reflects the strength of our run solution, but also our reputation for commitment to strong service.

Similarly, in the enterprise space, client interest in our next-gen HCM solution has exceeded expectations and resulted in strong Q4 sales, and we are excited to continue this great momentum.

As a result of this exceptional performance, our fiscal 2024 employer services bookings growth came in at 7%, the high end of our 4% to 7% guidance range. This growth speaks to the power of ADP's unmatched distribution model, which remains a clear competitive advantage for us. With our new business pipeline even stronger than this time last year, we look forward to building on that momentum.

Overall, our employer services retention came in better than expected for the year at 92%. We drove record level retention in our mid-market business for the second consecutive year in fiscal 2024.

I'm also extremely proud to share that our client satisfaction scores for our total business reached new all-time highs for both the fourth quarter and full year. These results are a testament to the strength of our entire product portfolio and our commitment to supporting our clients. We are confident that these client satisfaction gains will support our retention results moving forward.

Our employer services pays per control increased 2% both for the quarter and the full year. We were happy to have seen the resilience of the US Labor market, as our clients continued to hire employees at a moderate pace. Finally, our fourth quarter PEO revenue growth of 6% exceeded our expectations despite continued pressure from slowing client hiring activity.

Our fiscal 2024 accomplishments extend far beyond our strong financial results. One year ago, I laid the foundation for our three strategic priorities that will guide our future growth.

Now, I'd like to recap some of the great progress we made in each of these areas. Our first priority is to lead with best-in-class HCM technology. We had a very busy year on this front as we launched ADP Assist, our cross-platform solution powered by generative AI that transforms client data into actionable insights. This isn't just another technical solution, it's an experience that combines ADP's deep data set and expertise to empower HR professionals, leaders, and employees.

We deployed ADP Assist across several of our platforms, including Roll, RUN, Workforce Now, and next-gen HCM, with enhanced capabilities ranging from report creation to natural language search to initiating HR actions. These tools streamline daily tasks and are all powered by an easy-to-use

search interface that is already receiving meaningful recognition in the field of generative AI. We are very proud to share that ADP Assist earned the Generative AI Innovation Award in the 2024 AI Breakthrough Awards, and we look forward to rolling out even more features in fiscal 2025.

In addition to embedding generative AI in our products, we continued to advance our next-gen initiatives. Our active next-gen payroll client count increased by nearly 50% in fiscal 2024, and we grew our number of live next-gen HCM clients by more than 30% as we continued to improve implementation times. Our next priority is to provide unmatched expertise and outsourcing.

Our approach to supporting our clients has been key to our winning formula for decades. And in fiscal 2024, we focused our efforts on implementing new technology that will help make an even greater impact for our clients.

To further unlock the value of our expertise, we deployed generative AI tools like call summarization and real-time guidance to support our service associates. We also invested in generative AI and other automation capabilities for our implementation teams to reduce manual data entry and minimize the risk of error during implementation.

For example, out of the 50,000 new RUN clients we sold and started during the fourth quarter, about half were digitally onboarded compared to a third of our new client onboarding and run this time last year. And as generative AI capabilities advance, we are excited to further accelerate this progress. Finally, we plan to provide additional tools to help our associates deliver better, faster service, and allow our client satisfaction scores to continue reaching new record levels.

Our third strategic priority is to benefit our clients with our global scale. Globally, we bring together an unmatched footprint, best-in-class integrated solutions, and industry-leading service and expertise to help our clients and their employees navigate the changing world of work.

In fiscal 2024, we continued to leverage this global scale to strengthen our business. We extended our global footprint, acquiring the payroll business of our partner in Sweden, expanding the scope of our Celergo payroll offering to include Iceland, and further growing our on-the-ground presence in the APAC region. Our iHCM platform also continued to scale in several European countries and now serves more than 5,000 clients and pays more than 1 million client employees.

Finally, we deepened our existing partnerships with several other leading technology providers to further simplify HCM processes and broaden the spectrum of support we can provide our clients. Next, I'd like to share some new client wins from Q4 to highlight how we're leading in workforce innovation and delivering value for our clients. In US Small business, we continue to successfully onboard new retirement services clients across multiple industry verticals.

During the quarter, we added the plan of a Texas-based insurance agency, which was challenged by manual processes and the management of multiple providers. ADP's advanced technology and planned fiduciary solutions simplified the client's plan administration, reduced its manual oversight, and lowered its plan fees. The ADP team made the transition easy and stress-free by providing the client with critical management of the transfer process, as well as regular briefings on the plan set up. This is just one of the thousands of new clients who turn to our retirement services solution every year.

In fact, we recently took the top spot as the nation's largest 401-k record keeper by Total Plans and Total 401-k Plans in the Plan Sponsor Magazine 2024 defined contribution Record Keeping Survey. We serve over 170,000 retirement services clients and it brings me great joy to see how ADP is helping employers address the retirement savings needs of so many Americans. We look forward to continuing the momentum in our retirement services business in fiscal 2025.

In our HR outsourcing business, an orthopedic device company who had grown extensively through acquisition recognized it needed a deeper HR and technology infrastructure to support its future growth. So it turned to our comprehensive services support model to integrate its acquired companies onto a common platform. We look forward to supporting this client's current needs and helping it expand in the future.

Additionally, comprehensive services cost a major milestone in fiscal 2024, generating more than \$1 billion in revenue for the year. This business has come a long way since its launch in 2008, and we look forward to leaning into our outsourcing business as a differentiator.

In US Enterprise, we welcomed one of the largest automotive dealers in the Midwest to our next-gen HCM platform. Following several years of rapid growth, this client wanted to reimagine their HCM strategy. To help, our team went on-site and conducted a deep review of its current practices and pain points. We developed a plan that would leverage our next-gen HCM platform, flexible position management structure and other advanced HCM tools to address the organization's current and future HR strategy.

Our initial solution included HR, payroll, time, and benefits, and the client later added recruiting and talent management. We look forward to helping shape the future of their workforce together. Overall, we were extremely pleased with our strong financial and strategic outcomes this past year. In fiscal 2024, ADP was recognized as the world's most admired company by Fortune magazine for the 18th consecutive year, and we also celebrated our 30th straight year on the Fortune 500.

As some of you may know, 2024 is also our 75th anniversary. As I reflect on ADP's enduring impact on the world of work, the one constant on our journey is our talented associates, be it the recent accolades we received or the 75 years of support for our clients, we owe our recognition and strong financial performance to our 64,000 dedicated associates who deliver the great products and exceptional experiences and continue to drive our client satisfaction scores to new highs.

I want to take a moment to recognize them for their incredible contributions. Thank you for all you do for ADP and for our clients. And now, I'll turn the call over to Don.

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Thank you, Maria. And good morning, everyone. I'll start by expanding on Maria's comments around our Q4 results and then cover our fiscal 2025 financial outlook. Q4 performance was very strong overall, helping to drive fiscal 2024 revenue and earnings growth towards the high end of our expectations. As previously mentioned, we benefited from broad-based strengths in employer services with exceptional new business bookings, better than anticipated retention, and stable pays per control growth.

PEO revenue growth in the quarter also came in better than expected. Our strong Q4 results contributed to our full year revenue growth of 7%, bringing our fiscal '24 revenue to \$19.2 billion. For our employer services segment, revenue in the quarter increased 7% on both a reported and organic constant currency basis. These results were bolstered by a slightly better than expected contribution from client funds interest.

Our ES margin expanded 220 basis points in the fourth quarter, which exceeded our expectation. For the full year, our ES revenue grew 8% on a reported basis and 7% on an organic constant currency basis, and our ES margin expanded 210 basis points. For the PEO segment, revenue increased 6% for the quarter as growth accelerated from Q3.

Average worksite employees increased 3% on a year-over-year basis in the fourth quarter to 742,000. PEO margin contracted 240 basis points, slightly more than we anticipated due to higher operating expenses and unfavorable actuarial loss development in workers' compensation reserves.

For the full year, PEO revenue grew 4%. Average worksite employees increased 2% and our margin contracted 150 basis points, with the margin contraction mostly due to less favorable actuarial loss development in workers' compensation reserves versus the prior year. Our fiscal 2024 PEO new business bookings growth rate also moderated from the prior year. I'll now share outlook for fiscal 2025. While the macro backdrop remains uncertain, we believe we are well positioned to deliver solid overall financial results while continuing to invest in our future growth consistent with our strategic priorities.

Our fiscal 2025 outlook assumes some moderation in economic activity over the course of the year. Beginning with the ES segment, we expect revenue growth of 5% to 6%, driven by the following key assumptions. We expect ES new business bookings growth of 4% to 7%, representing solid growth after coming in at the high end of the same guidance in fiscal '24. For ES retention, we forecast a 10 basis point to 30 basis point decline from the 92% result for fiscal 2024.

We are encouraged by our recent record client satisfaction scores, but we think it's prudent to continue to expect some retention pressure from higher small business out of business levels and slightly slower economic growth overall.

As we mentioned at our prior earnings call, we see the potential for below normal US pays per control growth in fiscal 2025. And our outlook assumes 1% to 2% growth for the year. This view is consistent with most economists forecast for continued moderation in US private sector payroll growth. After price contributed around 150 basis points to ES revenue growth in both fiscal '23 and fiscal '24, we anticipate a benefit closer to 100 basis points in fiscal '25, which is in-line with the moderation in overall inflation.

We also expect FX to transition from a modest tailwind to ES revenue growth in fiscal '24 to a slight headwind in fiscal '25. And for client funds interest revenue, the interest rate backdrop remains dynamic. And it's important to remember our client funds interest revenue forecast reflects the current forward yield curve, which is likely to continue to evolve as we move through fiscal '25.

At this point, we expect our average yield to increase from 2.9% in fiscal '24 to 3.1% in fiscal '25, which contemplates the market's expectations for short-term interest rates to decrease during the year.

We expect our average client funds balances to grow 3% to 4% in fiscal 2025. Putting those together, we expect our client funds interest revenue to increase from \$1.02 billion in fiscal 2024 to a range of \$1.13 billion to \$1.15 billion in fiscal 2025. Meanwhile, we expect net impact from our client fund strategy to increase to a range of \$1 billion to \$1.02 billion in fiscal '25.

We expect ES margin to increase 100 to 120 basis points in fiscal 2025, driven by operating leverage as well as continued contribution from client funds interest revenue partially offset by ongoing investments to advance our key strategic priorities.

Moving on to the PEO segment, we expect PEO revenue to grow 4% to 6% and PEO revenue excluding zero margin pass-throughs to grow 3% to 4% in fiscal '25. Our PEO revenue growth outlook assumes average worksite employee growth of 1% to 3%. This reflects our expectation for continued new business bookings growth and modestly better retention to be offset by declining PEO pays per control growth that remains below our historical experience.

We expect PEO margin to decrease 90 to 110 basis points in fiscal 2025. This anticipated margin decline reflects our forecast for zero margin pass-throughs to grow faster than PEO revenue and increase in our workers' compensation costs and higher PEO selling expense from accelerating new business bookings growth. Adding it all up, our consolidated revenue outlook is for 5% to 6% growth in fiscal 2025. And our adjusted EBIT margin outlook is for expansion of 60 to 80 basis points.

We expect our effective tax rate to be around 23%. And we expect fiscal 2025 adjusted EPS growth of 8% to 10% supported by buybacks. One quick note on our margin cadence. We anticipate adjusted EBIT margin expansion on a year-over-year basis to be more modest in the first half of the year before trends ramp in the second half of fiscal 2025.

Thank you. And I'll now turn it back to Michelle for Q&A.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Bryan Bergin, TD Cowen.

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### Bryan Bergin - TD Cowen - Analyst

Hi. Good morning. Thank you. I want to start with bookings here. So sounds like a pretty solid close to the year. Can you provide more color on the attribution of that bookings performance across the business? And in general, I guess when you're looking at demand into July, just any changes based on employer size or geography?

**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Sure, good morning, Bryan. Great to hear from you. I love talking about bookings, especially on the heels of what was truly an exceptional performance by the overall team in the fourth quarter.

To answer the first part of the question, it was broad-based. So we did see strength across our growth in small business, mid-market, enterprise, and international. So we are really pleased with the momentum that we see as it relates to the overall receptivity to the offerings, to the product, to the execution, and really proud of how the team moved through the quarter, which led to the exceptional results at 7% for the year.

In terms of the demand environment overall and what we see, what I would offer is that the HCM demand environment remains strong. One of the things that's unique about HCM is what we do, it's not a nice to have, it is actually an imperative for a company to run their business. They need to have their associates pay, they need HR tools, and certainly it's not getting any easier.

Whether you're in the down-market, mid-market, up-market, to navigate being an employer. And as such, we fit squarely into that. So we feel good about the momentum stepping out of the quarter. We feel good about the demand environment stepping into the quarter. Pipelines from a year-on-year perspective look strong. So we're very optimistic and proud of the performance.

**Bryan Bergin** - *TD Cowen - Analyst*

Okay, I appreciate that. And then my follow-up, just on pays per control performance here, can you compare and contrast the pays per control performance in ES versus what you're seeing on the same store sale, PPC and PEO. And any cadence assumptions here as you go through '25?

**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Yeah, Bryan, I'll take that one. So as we look at pays per control, we do think that the labor market is still pretty resilient. I mean, there are a number of factors that we look to. And, you know, if you look at the BLS, you look at the unemployment rate, JOLTS Report came in the other day, it was down, but better than expected. Labor force participation still got some room to go, et cetera. So jobless claims are kind of neither here nor there. They're benign. So we think there's still continued good strength in the market.

Having said that, we do think that pays per control is going to moderate. And we have said we're thinking 1% to 2%, as we go forward into 2025. I would say that we do expect that the pays per control growth in the PEO will be lower than it is in ES, but we are still optimistic that there's growth to be had, but certainly we expect ES to be somewhat stronger than we expect PEO.

**Bryan Bergin** - *TD Cowen - Analyst*

Thank you.

**Operator**

Dan Dolev, Mizuho.

**Dan Dolev** - *Mizuho Securities USA LLC - Analyst*

Oh, thanks guys for taking my question. You know just to touch again on ES, like -- I want to know like how much of that strength is idiosyncratic and things that you're doing internally versus the macro. And then maybe the follow-up is again asking about the guidance and like maybe you

can layout you know what could go well and what could go wrong in terms of the macro -- the underlying macro for the guide that would be it. Thank you.

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**Don Edward McGuire** - Automatic Data Processing Inc - CFO

Yeah Dan. So you know just to follow up on that, I would say that you could will unemployment remain as low as it has been? I think there's no indication that it's going to worsen. It's still at, decade lows or comparable to decade lows. There is good strength, there seems to be good strength across the broader spectrum of new jobs. So the NER report came out earlier today and we're continuing to see new jobs.

So I think that we put out there a PPC growth number that's realistic. What could change that? We could imagine all kinds of macro issues, but I prefer not to do any imagining. I think we're trying to do what we can based on what we know today. So I think that what we have today is pretty good. But as I mentioned earlier to Bryan's question, we certainly recognize that ES is likely to be stronger than PEO.

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**Maria Black** - Automatic Data Processing Inc - President, CEO & Director

And Dan, if I can just add on the sales side, just with respect to -- are we driving the results as it being driven by Macro? My answer to you would be both. And so I think we have a strong demand environment. I touched on that during Bryan's question in terms of our offer and how squarely it fits into that demand environment. And that's really a broad-based execution across the entire business.

So it is the investments we've made into our products. It is the best-in-class service that we have. We see that in the NPS results, by the way we see that in our retention results as well.

And so I think we've been getting stronger and stronger. I think the value proposition of what we offer is an imperative for businesses. And then once again, I would say, yeah, we are executing incredibly well across the full spectrum of our sales differentiation. I mentioned in the prepared remarks, I consider it to be one of the greatest competitive advantages that ADP has. Part of that is our ability to canvas the entire market.

So whether buyers trying to buy digitally, or they're trying to buy through a channel, or they're trying to buy the traditional way, like we show up at every single turn, and we lean right into that with the best product and the best service out there. And as a result of all of those things, I think we are executing very well.

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**Dan Dolev** - Mizuho Securities USA LLC - Analyst

Great results. Thank you.

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**Operator**

James Faucette, Morgan Stanley.

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**James Faucette** - Morgan Stanley - Analyst

Great. Thank you so much. I wanted to ask on competition. Some of our recent conversations with those in the industry have kind of indicated that there's been some meaningful price compression from some of your competitors, particularly in the mid and down market segments. Have you observed others getting more competitive on price or from your perspective, is it fairly status quo right now?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Good morning James. What I would offer is it is pretty status quo. We haven't really observed any of those meaningful price compression, things of that nature. Given how much we do compete, I think we would see -- I'd say, that there is always some of that in terms of whether it is promotions and things that all of us run at various times throughout the year. But it doesn't seem atypical for me. And obviously, I've spent a lot of years watching the competitive landscape and the sales environment.

So I haven't seen anything anomalous. I think the one thing that's changed, specifically in the competitive landscape is us. And so when I think about our ability to execute, and everything I just mentioned, best product, record retention, record NPS, incredible execution by sales. I think we are stronger than we've ever been. So I'd say, that's the shift. But from our purposes, it is still a competitive environment and we lean into it every single day.

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**James Faucette** - *Morgan Stanley - Analyst*

Great. Glad to hear that. And then wondering if you can give a little bit more color on the composition of bookings, especially between enterprise, mid-market and down market. And also, what are you seeing in the international business? And how should we think about the potential uplift there over time, as price points in lower-cost regions continue to improve?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

What I would offer is that the down market had incredible strength by the way on top of incredible strength last year. I think I mentioned -- or I did mention during the prepared remarks, we onboarded, we sold and started 50,000 new clients in small business in the fourth quarter alone. So we are officially got 890,000 of our 1.1 million clients are in that down market space. And so we continue just to see broad-based demand. And again, we're executing very well on that.

Our mid-market sales results were phenomenal. Just an incredible execution by the team. Again, our product has been getting newer and stronger, so feel really good about that. I mentioned also in the prepared remarks what we saw in the enterprise space, specifically with respect to our next-gen HCM offering.

One of the reasons I'm so excited about this is that we are seeing record results, we are seeing more than we anticipated, quite significantly more than we anticipated. And we are not even at general availability yet. And what that suggests to me is that the market is ready for this offering -- the market is excited about this offering. We see clients wanting to buy in the enterprise space from ADP, and we are stepping into that opportunity. So that's the distribution. Very strong strength.

You asked about international specifically. International had a fantastic year overall. So it was really the story of four quarters. I think first quarter of last year was strong over year-on-year first quarter of 2023. Second quarter got even stronger. Third quarter got even stronger than that. And fourth quarter, you'll probably guess got even stronger than that. So overall, our international business had just a fantastic year as well.

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**James Faucette** - *Morgan Stanley - Analyst*

That's great. I appreciate all the color, Maria.

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**Operator**

Ramsey El-Assal, Barclays.

**Ramsey El-Assal** - Barclays - Analyst

Hi, thanks for taking my question. I wonder if you could comment on how you're thinking about the balance -- striking a balance between pricing and retention and just -- also speak to your confidence level about being able to take that 100 basis points of pricing, which I think is more than you took sort of pre-pandemic, although less than you've been taking in this really inflationary environment. How are you -- how confident are you that you can take that without tipping retention in the wrong direction?

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**Don Edward McGuire** - Automatic Data Processing Inc - CFO

Thanks for the question Ramsey. Yeah, it is a great question because we always think really, really hard about pricing decisions and making sure that we don't get greedy. As we've shared on many occasions, what we are interested in is long-term clients and the lifetime value of those clients. So we are always very, very careful not to over rotate on price. And you are right, we have been able to take about 150 basis points in '23 and '24.

And as we look to '25 and we looked at the moderating inflation environment, we thought that 100 basis points is realistic. If we go back pre '23 and back into the teens we were more on the 50 basis points range, but the inflation environment was very, very different then it was virtually not existent. So we are confident that we can get 100 basis points. We are confident that we can target it in the right places. So it is something that we think is a reasonable expectation for us to target.

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**Ramsey El-Assal** - Barclays - Analyst

Okay. And a follow-up for me is about generative AI. And just if you could talk about how we should think about the long-term opportunity there in terms of monetization. Is this ever something that could contribute to revenue directly? Or is this -- is generative AI sort of more something that will drive soft dollars to retention, new bookings? Obviously, there is an expense benefit internally. But I'm just curious about how you're framing it up over the long term.

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**Maria Black** - Automatic Data Processing Inc - President, CEO & Director

It's a great question. My answer to you would be both. And so from a generative AI perspective, I know you know that I love to speak about it. I talked about it again at length just this morning during the prepared remarks.

What I'd offer is that all across, whether it is the focus we have of putting generative AI, ADP Assist across and into each one of our products, or it is the work that we're doing with putting ADP Assist into the market to help practitioners, or help our own service associates and our sales associates, the way I think about it, first and foremost is exactly what you suggested, which is it should feed the ADP model.

And in its most simplistic form when I think about this company and driving the recurring revenue model that we have, it is about sales, it is about retention, it is about product efficiency and it's about NPS. And those four metrics, generative AI and everything that we are offering as it relates to ADP Assist should feed, call it the machine of our model, right?

So we should have more sales, we should be able to keep clients. Why? Because they are happier and they have a better experience as it relates to NPS. And then in turn, we also drive efficiency. So I think that's the output and the outcome of a lot of the investments we are making.

That said, as we look at all the use cases and both the short-term stuff that we're working on, as well as the long-term vision of what ultimately generative AI could look like in the coming years, we do see monetization opportunities. And each one of our business cases, as you can imagine, has clear goals of what it is that we are trying to accomplish, inclusive of revenue growth.

I think it's too early to start sharing some of those broadly across the market. But certainly, that's a big piece of our strategy, as is making sure that we continue to drive the transformation type of opportunities that we've been driving for years as a company.

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**Ramsey El-Assal** - *Barclays - Analyst*

Fantastic. Thank you.

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**Operator**

Samad Samana, Jefferies.

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**Samad Samana** - *Jefferies - Analyst*

Hi, good morning. Thanks for taking my question. Don, maybe one for you. Just on the PEO guidance, and I apologize if this question is kind of a dumb question, but I just want to make sure I understood it. If I look back to last year, you had actually a slightly better WSE assumption, and you guided to 3% to 5%.

And this year, you are assuming lower WSE growth but actually slightly better revenue growth. And I was just trying to reconcile those two things. Is retention assumptions the big difference there? Or is there some other mechanical thing, it is easier comps? I'm just trying to understand the PEO guidance this year versus last year.

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

No, Samad, it is a great question. So there are a few things happening if you look forward to 2025, revenue is growing, but the biggest contributor to the revenue growth is zero margin pass-throughs. So that's the largest component, and that's what's happening there. And then, of course, we have mentioned earlier that pays per control are under pressure.

So as I said in an earlier answer, 1% to 2% for ES, and we think more towards the low end of that for the PEO area. And then we have a little bit of pressure from workman's compensation on the margin. And I guess the third thing is we do continue to focus on the area to get sales reaccelerating. So we certainly have more selling expense baked in to that business to help drive the top-line and make sure we get to continue to grow our worksite employees.

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**Samad Samana** - *Jefferies - Analyst*

Understood. And Maria, if I take just one huge step back, the business is very strong right now, and it seems like that's happening in what is a backdrop that is slowing. And so I just was wondering, you've been at ADP for a long time, you've seen multiple cycles, can you just remind us that when you see a broader slowdown in the backdrop, just how you still are able to drive value and what the performance of the business has historically been in these slowdown periods, because I think we are all impressed by the durability of the strength even as things may be slow in the backdrop?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Yeah. Thanks, Samad. And you are right. I think the durability of what it is that we offer, I spoke to it a bit earlier in terms of the imperative of HCM, I think that durability also lends itself to a different environment should the macro change. So the sales force of ADP, if you will our offering is great in times of growth, it is great in times of steady, and it's also great as a conduit as there might be pressure in the employer environment.

And so the value proposition, we have a playbook. We can adjust very, very quickly in terms of what it is that we offer and as the demand environment shift. Now that said, should there be a huge decline in the macro, of course we will be impacted. One of the things that does end up getting impacted is bookings. But at the same time, from a standpoint of the self-adjustment of that value proposition, it's very durable, and it is very durable, as a result of HCM being an imperative.

And so we feel good about our ability to flex. And I've seen that, to your point Samad, I've been here a long time, as a student of ADP's great distribution, and I've seen that flex over time and have all the confidence that the team would do the same. I think maybe Don could also talk about the -- how that financial model, should something shift in the market, the financial model also self-adjusts as it relates to the playbook, if you will in a different macro.

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Yeah, certainly. We've talked about this before. But if we go back a year or so, I think -- or maybe 18 months, the word recession was on people's lips a lot more frequently than it is today. I think the latest survey I've seen says that there is about a 28% probability of recession in the next 12 months. I'm sure that's some survey that the rest of you have read somewhere as well. So the good news is, it looks very unlikely that we are going to have a recession over the next 12 months.

But certainly, as an all-weather company, what we do isn't discretionary. You have to do it. The levers we have, if sales slow commissions slow, if implementations slow, we don't need as much headcount, et cetera, et cetera. But I think, as we saw in 2008, it took a long time for ADP to find itself in a place that looked like a lot of adjustment. So we think that we can use those tools again should we need to. But I'll just finish with hopefully, that survey is correct and nobody is thinking about a recession in the next 12 months.

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**Samad Samana** - *Jefferies - Analyst*

Great. Appreciate it. Thank you.

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**Operator**

Mark Marcon, Baird.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated - Analyst*

Hi, good morning. And thanks for taking my questions. Congrats on the strong bookings in the fourth quarter as well as the really strong retention. I wanted to dive a little bit deeper into both. With regards to the strong bookings, Maria, you cited on the small business side, RUN doing extremely well, getting 50,000 new clients. Can you talk a little bit about what the source of those clients are? Were those clients that were using competitive solutions? Were they brand-new business formations? How would you characterize that? Where are you seeing the strength and the takeaways from?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Sure. So on the down market specifically as it relates to bookings, the bookings again, are broad-based, right? So where are we getting them? We are getting them from digital inbound, we're getting them from new businesses, we are getting them through the ecosystem of our channels, so clients that are engaging with banks, CPAs. Again, we canvass the entire market.

That said, some of the things that we have seen, Mark, year-on-year new business formations, it is still at an elevated rate, but it is pressurized. So sorry, year-on-year, it is minus 3%, but it's still elevated compared to norm. And so as a result of that, we did see less coming this time from new business formations. Now we had a lot come from new business formation, but we also saw an increase in balance of trade, some more coming from the competition.

So what I would say is mix shifted a little bit in terms of how we broadly canvass the down market. All that rolled up to this incredible result of 50,000 units in the fourth quarter. So it is broad-based, but there are tiny bit of shifts within that to answer your question specifically.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated - Analyst*

Great. And then on next-gen HCM, you also mentioned a 50% pickup there in terms of new sales. And this is before you are fully GA. Can you talk a little bit about what the source of the wins are in terms of -- are these clients that are transitioning from older ADP platforms? Or are they coming from competitors? And if it's from competitors, what sort of competitors?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Sure. The answer is both. And also head-to-head against competition. So some of them are ADP upgrades. We did see more new logos than we've seen before. So we are really excited about the net new wins to ADP. Some of those were wins and takeaways from enterprise competitors.

Some of them were wins head-to-head against the same said enterprise competitors, which again is probably why I'm so optimistic about it, because it appears that the offer that we have is competing incredibly well in the market and clients are choosing ADP.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated - Analyst*

That's great. And then with regards to client retention, I know you are guiding prudently for a normalization. But it seems like your client satisfaction scores continue to trend up. How would you characterize the primary drivers of the improved client satisfaction? Is it the solution set? Or is it the service underlying, or a combination of both?

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

It is a combination of both. NPS is fantastic. So NPS for the quarter as well as the full year was a record. Almost every single business is at a record NPS. So what drives NPS? It is that both, right? So it is the investments we've made into our best-in-class products. And this is years that we've been making these investments and making our products newer and more modern taking friction out, making them more self-service.

All of these things that go into having best-in-class HCM technology, those investments coupled with best-in-class service, is driving the broad NPS record that we have across the business. So as such, that is a direct correlator to a record retention.

And so we are really proud of the 92%. You are right. We're prudently guiding into the year again. And the reason behind that is, as you know we've had this conversation many times, is that there is still perhaps some normalization that could happen, and also because we are executing at all-time highs almost across every single business. We just want to be thoughtful as we step into the year to make sure that the retention guide is prudent.

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**Mark Steven Marcon** - *Robert W. Baird & Co. Incorporated - Analyst*

Got it. Thank you.

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**Operator**

Tien-Tsin Huang, JPMorgan.

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**Tien-Tsin Huang** - *JPMorgan Chase & Co - Analyst*

Hi. Perfect. Just want to extend on the retention, but more on the outlook side, if that's okay. Just any callouts expectation-wise across the segments, small, mid, and large? I know you've commented on balance of trade already, but I didn't know if you are seeing anything different in terms of expectations on retention.

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Yeah, fair. What I would offer is it is the same reason that we guided into the year, this year the way that we did, this year that we just closed, it is expected potential normalization in the down market. Now I've been saying that for the last couple of years. It isn't -- yeah I know. The down market isn't entirely normalized back to where it was pre-pandemic. Now I get that that's five years ago and it may be at some point, we all have to just suggest that it is the new normal.

But we haven't seen an uptick in bankruptcies, out of business at the levels that we used to see in that business. And as such, we believe it is prudent that there could still be some of that normalization. So it's really the same thing that we've been suggesting. It just hasn't happened yet. And our goal would be of course, to not have it happen again.

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**Tien-Tsin Huang** - *JPMorgan Chase & Co - Analyst*

Yes. And you did outperform, obviously the guidance you set last year this time, so okay. No, I just wanted to check. I think this -- again, you've said prudent and totally agree with that. Just my quick follow-up just is on the margin front. I know it is very typical margin expansion. I think you did call it last quarter, maybe a little bit more investment in G&A. Anything different in terms of incremental margin outlook for fiscal 2025? It does look like you have a workforce rebalancing in the fourth quarter as well. So I just want to make sure we call it the puts and takes there on the margin front. Thank you.

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Yeah. So Tien-Tsin, thanks for the question. I think that we are always -- I'll start with where you ended there. We are always looking at the workforce and making sure we're -- we've got the right people in the right places and the right numbers of people in the right places. So we're always looking at that. I don't think there is any real specific callouts on the margin. I think that there are some Gen AI investments. These are modest, but they do attract 10, 20 bps here and there, so to speak. But they are modest all things considered.

Certainly, the margin next year would get a little bit of pressure from lower pays per control from lower pricing increases and from lower client fund interest, most specifically in the back half. But I think those are all things that we've called out and you can read through. So nothing abnormal.

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**Tien-Tsin Huang** - *JPMorgan Chase & Co - Analyst*

Yeah. No, glad to see it's typical. And congrats to Danny and Matt as well. Thanks guys.

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**Operator**

Bryan Keane, Deutsche Bank.

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**Bryan Keane** - *Deutsche Bank - Analyst*

Hi guys. Congrats on the quarter really strong in ES. On PEO, the bookings were accelerating and recovering in fiscal year '24 but moderated towards the end of the fiscal year. So just want to understand what changed in the marketplace there.

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**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Sure. Good morning, and thank you by the way. I appreciate the congrats. PEO bookings did moderate a bit in the back half. And from a year-on-year perspective, it did moderate as well. That said there was still strong growth in PEO bookings. And so from my vantage point, the demand equation

is still incredibly strong for the PEO. It was a slight moderation year-on-year. We feel really solid about the demand for the offer, the value proposition of the offer, and we feel solid about pipelines in the PEO.

And as you know, with pipelines in the PEO, it is more about activity in the market, new appointments, requests for proposals, things of that nature. So all the bellwether signals show that the PEO strength is still there, but it did moderate a bit in the back half.

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**Bryan Keane** - *Deutsche Bank - Analyst*

Yeah. And just a follow-up just with thinking what would it take to get PEO back to high single-digit or double-digit revenue growth that was targeted previously?

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Yes. Hi Bryan, I think it's going to take a little bit of time. And we were working, and as I mentioned earlier, we are seeing some more margin pressure in PEO, and some of that is because of the investments we are making in the sales force to make sure we can get those bookings going. But realistically, to get to kind of Investor Day guidance that we provided three years ago, it is going to take some time to build that back.

So we are definitely focused on that, and we are definitely focused on getting there. Of course, if we were to see some reacceleration in the pays per control, that would put lots of wind in the sails, but it's going to take a little bit of time to get back to where we want to be.

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**Bryan Keane** - *Deutsche Bank - Analyst*

No, that makes sense. And congrats again.

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**Operator**

Scott Wurtzel, Wolfe Research.

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**Scott Darren Wurtzel** - *Wolfe Research, LLC - Analyst*

Good morning, guys. Thanks for taking my questions. I wanted to go back to the margin guidance and just the context of seems like slower expansion in the first half or second half. Wondering if you walk us through the drivers there are some more on the shape of revenue or does it have anything to do on the cost side? Thank you.

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**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Good question, Scott. More on the shape of expenses. Revenue expectations throughout the year are pretty consistent quarter-to-quarter. It is really some spending patterns we have in the first half of the year, but really nothing specific to call out. Just want to give folks a heads up that we think we are going to be stronger in the back half than the first.

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**Scott Darren Wurtzel** - *Wolfe Research, LLC - Analyst*

Got it. That makes sense. And just as a follow-up on the international side. I mean it seems like you're making some good traction on incremental countries and geographies. And we'd love to just hear about your sort of expectations for international heading into this year, how much of it is a priority for you relative to maybe other investments in the business and where you're maybe seeing opportunities internationally.

**Maria Black** - *Automatic Data Processing Inc - President, CEO & Director*

Yeah, fair, Scott. It is a very large priority for us. As you may remember, our third strategic priority is to benefit our clients with our global scale. International fits squarely into that strategic priority. We've been building this business for 50-some odd years. We are well ahead of the competition, as it relates to the number of countries that we serve on behalf of our clients, and moreover the infrastructure in those countries that we've built out.

So we often speak to the final mile and all the things that we do to ensure that our clients have the ability to pay across very complex, sometimes large complex clients or countries, and sometimes very small complex countries. But certainly, it is a big piece of our offer.

I think companies continue to want to think about their system of record from a global perspective, as they continue to have distributed workforces across the globe, as they continue to move supply chains in this world of globalization, as they have remote employees in smaller countries and around the world.

We have this incredible network and ability to support clients today in what is 141 countries, and we continue to add more, as they become prudent in terms of the -- again, if it is the growth economies or where our clients are heading, but it is a big piece of our growth story. It's a big piece of our differentiation in the marketplace. And our multi-country MNC business is a clear competitive advantage for us in the international space.

**Scott Darren Wurtzel** - *Wolfe Research, LLC - Analyst*

Great. Thank you.

**Operator**

Jason Kupferberg, Bank of America.

**Caroline Noelle Latta** - *BofA Securities - Analyst*

Hi. This is Caroline on for Jason. Thanks for taking our question. Can you talk about the duration of the portfolio? We were a little surprised to see that the F'25 average yield is expected to be up year-over-year based on the number of rate cuts being forecast. And maybe how you might be adjusting your investment strategy for the portfolio based on the interest rate outlook for the next 12 months.

**Don Edward McGuire** - *Automatic Data Processing Inc - CFO*

Caroline, thanks for the question. So we do have a laddered strategy. So if you actually refer to the -- I think, the last page of the earnings release, I think you can see the maturity schedule for our investments. And you can see that, for example in 2025, we have \$6 billion that's maturing at roughly 2.2%, and our reinvestment at this point in time is 4.2%.

So there's still lots of opportunity, and this is a place where ADP's laddering strategy shows its strength. It is fair to say that over the last couple of years, because of the inverted yield curve, we did have some opportunity cost by having this strategy. But I think we are very much seeing that as yield curves start to normalize, that we still have lots of opportunity for client funds interest growth.

I'd just add to that that the portfolio is continuing to grow. It's growing 3% to 4% again next year, maybe not as much as it has in the past couple of years because wages have moderated a little bit, pays per control moderated a little bit. But we are still seeing good growth in that area. So we still have lots of opportunity.



And the most important thing here, the most important comment I can make on this whole fund strategy, is that we base all of these commitments or all of these expectations on the current yield curve. We're not trying to outguess the market. We're looking at what the market in general has to say. And we are using those yield curves to put together our forecasts and our guidance on interest rates.

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**Jason Kupferberg** - Bank of America - Analyst

Okay, that's helpful. Thank you so much.

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**Operator**

Ashish Sabadra, RBC Capital Markets.

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**David Paige Papadogonas** - RBC Capital Markets - Analyst

Hi. This is David Paige on for Ashish. Thanks for taking our question. I just wanted to circle back to the workforce optimization charge that we had in the quarter of \$42 million. Should we expect further workforce optimization in 2025? And if yes, how much of that there, what's the benefit to the EPS guidance for '25 as well? Thank you.

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**Don Edward McGuire** - Automatic Data Processing Inc - CFO

David, as Maria has shared earlier, I mean, we're always looking to make sure that we've got the workforce at the size it needs to be and in the places it needs to be. So we made those difficult decisions that we had to make on behalf of some of those employees. But we always look at this. And if you look at ADP over the years, we've always done what needed to be done to go forward.

So I would just leave it at that and say that we're very happy with the guidance we put out here and the margin guidance as well. So we will make sure that we do what we need to do to execute, and we'll see what the future brings. But as we sit here today, we've done what we need to do, and we are looking forward to the future.

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**David Paige Papadogonas** - RBC Capital Markets - Analyst

Great. Thank you.

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**Operator**

Kartik Mehta, Northcoast Research.

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**Kartik Mehta** - Northcoast Research Partners, LLC - Analyst

Good morning. I know you've talked about the strength in bookings quite a bit. And I'm just wondering from an enterprise sales standpoint if there is been any change. Is the sales cycle lengthening at all? Are enterprises maybe asking to buy less modules they have in the past? Any change or has it been pretty much status quo and really no change from a demand or a sales cycle standpoint?

**Maria Black** - Automatic Data Processing Inc - President, CEO & Director

Fair. It is a great question. I think we talked about it a bit last quarter and perhaps throughout the year, which is that we're really at a new normal, as it relates to the overall sales cycles. It is reminiscent of what it used to look like pre-pandemic. But arguably, there are more decision-makers involved. The process has elongated a bit from where it was during the height of the pandemic. But the deals are moving through the motions. I would say that they are moving through the motions pretty typically.

But certainly, it's not as fast as it was at one point in time. But we're not seeing less modules. We are seeing a big conversation around global, a big conversation around global system of record, things of that nature, which again is where this next-gen HCM fits squarely into that demand. So the conversation shifted a bit, but that is not necessarily new news, Kartik. It's really what we've seen over the last couple of years, as a byproduct of how clients in that enterprise global space operate.

So certainly, that's how we are leading what that best offer across the enterprise and international space. But from a deal cycle standpoint, it is pretty similar to what we've seen throughout this year, which is more decision-makers involved and prudence, as it relates to the decisions that are being made, but not necessarily less modules or anything of that nature.

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**Kartik Mehta** - Northcoast Research Partners, LLC - Analyst

And then just on the small business side, I mean as you look at the health of the small business, anything that is changing or anything that would give you concern just as people get worried about the economy, or change in behavior?

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**Maria Black** - Automatic Data Processing Inc - President, CEO & Director

Yeah. Great question. So we monitor so many of these things, right? So I spoke to one of them earlier, which is the pace of new business formation. That tends to be a bit bellwether. Again, it is still elevated from norms, but it is down year-on-year. We are also monitoring our own out of business. We are looking at clients that call it suspend payroll and how many are sitting in that type of capacity. These are all things and metrics that we've monitored for years to ensure that we are seeing what is happening real time, if you will.

What I would say is there are little pockets, very similar to the new business formation of watch items that we have our eye on. None of it at this juncture gives us great pause. Quite the opposite. But at the same time, we are monitoring these things to make sure that we don't get surprised as it relates to the shift should there be one. But there hasn't been one yet.

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**Kartik Mehta** - Northcoast Research Partners, LLC - Analyst

Perfect. Thank you so much. I really appreciate it.

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**Operator**

Thank you. There are no further questions. I'd like to turn the call back over to Maria Black for any closing remarks.

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**Maria Black** - Automatic Data Processing Inc - President, CEO & Director

Great. Thank you. So I will end where I started, which is I'd like to take this opportunity to thank our 64,000 associates. All of the results that Don and I have the pleasure of getting on this call to represent, they are a byproduct of 64,000 associates that are all incredibly committed to having the best-in-class technology, the best service, and the biggest, broadest global scale.

And everything we do, whether it is from product innovation to our contracting process, to our sellers, to our service associates, it really takes the entire company being aligned on what I would suggest is a commitment to client and client centricity. In that spirit, I'd also like just to take a minute to thank our 1.1 million clients.

I will tell you, as we celebrated the 75th anniversary of ADP, it was quite a remarkable moment to think about all the clients that we've impacted over 75 years and had the honor of contributing to their journeys of success and navigation. So definitely want to take a minute to honor all of our clients.

And then last but not least, all of you who dialed-in today, I appreciate you joining us. I appreciate your interest and your investment in ADP. And I look forward to speaking with you soon.

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### Operator

Thank you for your participation. You may now disconnect. Everyone, have a great day.

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