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ADP.OQ - Q4 2023 Automatic Data Processing Inc Earnings Call

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OVERVIEW:

Company Summary

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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 Fiscal 2023 Earnings Call. I would like to inform you that this conference is being recorded. After prepared remarks, we will conduct a question-and-answer session. Instructions will be given at that time.

I would now like to turn the conference over to Mr. Danyal Hussain, Vice President, Investor Relations. Please go ahead.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

Thank you, Michelle, and welcome everyone to ADP's Fourth Quarter Fiscal 2023 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 and full year. Our earnings materials are available on the SEC's website and our Investor Relations website at investors.adp.com, where you will 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. A 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 also 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 our 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, Danny, and thank you, everyone, for joining us. We closed out the year with a strong fourth quarter that included 9% organic constant currency revenue growth, 270 basis points of adjusted EBIT margin expansion and 26% adjusted EPS growth. And for our full year fiscal 2023, we delivered 10% organic constant currency revenue growth, 130 basis points of adjusted EBIT margin expansion and 17% adjusted EPS growth representing another strong year for ADP.

I'll start with some highlights from the quarter. Our worldwide sales and marketing team delivered exceptional Q4 Employer Services, new business Bookings growth that was well in excess of our expectations with strong double-digit overall growth on top of a difficult comparison. The HCM demand environment has been healthy despite a gradually slowing macroeconomic backdrop, and we have been capitalizing on this steady demand.

Our strong bookings results were broad-based. We had continued strength in our down market and Employer Services HRO offerings, we also had better-than-expected results in our mid-market as well as a great finish from our compliance and international businesses. This Q4 performance brought our full year Employer Services bookings growth to 10% compared to our 6% to 9% guidance and our medium-term goal of 7% to 8% growth that we laid out at our 2021 Investor Day. We are, of course, thrilled with this result and excited to keep the momentum going.

Our Employer Services retention rate was another highlight in Q4 and came in better than we expected. For the full year, we delivered a retention rate increase of 10 basis points and are back to our record level retention rate of 92.2%, all while absorbing the impact of normalization in the down market out of business rates. This strong result was driven by record-level retention rates, specifically in our U.S. mid-market and international businesses and by record level overall client satisfaction across our major businesses in the fourth quarter.

Our Employer Services pays per control growth was 3% for the quarter as the overall labor market continued to show resilience, bringing the full year pays per control figure to 5%. We have been pleased all year to see such durable labor demand from our clients. And last, while our PEO revenue growth performed in line with our expectations this quarter, we were pleased to experience a further acceleration in PEO bookings with strong double-digit growth in Q4, representing another record level sales quarter.

Moving on, while Don will cover our fiscal 2024 financial outlook, I wanted to spend a few minutes sharing our strategic priorities as we look ahead. Change and increase in complexity are secular growth drivers for the HCM industry. And our breadth enables us to address nearly any HCM challenge our clients may face and meet them wherever they may be on their HR journey. From start-up to enterprise, from software-only to fully outsourced, and from local to global, we see a tremendous growth opportunity in front of us. And while our specific growth initiatives will vary by business, there are 3 key strategic priorities, which apply across all of ADP that I see as critical to enabling our growth in the years ahead.

The first strategic priority is to lead with best-in-class HCM technology, put simply, our goal is to design, develop and deliver the very best and most innovative solutions that will help our clients navigate the full life cycle of employment. From hiring employees to onboarding and training them, providing insurance for them, paying them and filing payroll taxes and even setting them up for retirement.

As much as we offer today, we see an incredible opportunity to improve on our current and next-gen solutions, tactically use partnerships and inorganic means to further accelerate our pace of innovation and continues to offer industry-leading HCM products, and we expect to have a busy fiscal 2024. For U.S. small businesses, we are rolling out several product enhancements that will serve our 850,000 RUN clients, including a new tax ID registration service, learning management to help with small business employee training and an insurance inspector tool that utilizes AI to help clients manage their workers' compensation, insurance policies and annual audits.

For U.S. midsized businesses served by Workforce Now, our focus is to continue our great momentum in the deployment of our Next Gen Payroll and time engine and to drive our win rates and client satisfaction even higher. In the U.S. enterprise space, we expect to nearly finish the migrations of 3 of our remaining legacy platforms by the end of this fiscal year representing an important step in our multiyear journey to move our clients to more modern platforms.

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We are also pleased to have advanced the velocity of our Next Gen HCM implementations, and we expect our Next Gen HCM sales to contribute in a more meaningful way to our bookings growth in fiscal 2024. Outside the U.S., we intend to scale our iHCM mid-market platform in fiscal 2024, adding at least 1,000 clients over the course of the year. I am also incredibly excited to share that we will begin offering Roll outside the U.S. in fiscal 2024 to drive incremental growth.

We plan to launch initially in 2 countries in Europe and expand its reach from there, and we intend to continue growing our Asia Pacific business, in part by leveraging our recent acquisition of a strong mid-market time product to supplement our existing payroll functionality. And across a few of our platforms, including Workforce Now and Roll, we intend to deploy Gen AI-powered features to help our clients more quickly and easily tackle certain HR transactions.

Our second strategic priority is to provide unmatched expertise and outsourcing to our clients. We pride ourselves on serving as a true partner to each and every one of our 1 million clients. Our culture of client service applies equally across our entire business, from a basic payroll client to a fully outsourced client where we run part or all of the HR department. Our expertise and partnership approach has been key to ADP's winning formula for decades, and we will continue to lean into it. We expect that to manifest in a few ways in fiscal 2024.

We have recently been piloting a number of tools powered by Gen AI that can help our service and implementation associates deliver an even better client experience, and we will begin deploying these more broadly in early fiscal 2024. Given the significant number of clients we onboard and interact with every year, we expect to learn quite a bit this year about the longer-term benefits we and our clients might realize from Gen AI.

Meanwhile, demand for our HR outsourcing solutions remains very strong. And in fiscal 2024, we are focused on reaching new clients and further improving the experience for existing ones. Our Employer Services HRO businesses have been performing incredibly well, and our focus for fiscal 2024 is to continue delivering strong bookings and keep client satisfaction and retention at current levels, or perhaps even reach new record levels. And our focus for our PEO business in fiscal 2024 is to maintain our recent strong bookings momentum by continuing to add to our sales force headcount, grow our referral partner network, and use data and machine learning to identify existing ADP clients who may be a strong fit for an upgrade.

Our third and final strategic priority is to leverage our global scale for the benefit of our clients. Our size and scale are unmatched in the industry. Across the globe, we not only offer robust platforms and a commitment to industry-leading service and expertise, but we also provide a scaled ecosystem and a unique on-the-ground presence in over 30 countries. This combination positions us to interact routinely with local governments and tax authorities, meet stringent certification and data requirements, and stay on top of complex and shifting legal requirements.

Globally, we bring together our incredible data an array of partners and integrated solutions in one of the biggest and best business-to-business sales forces in the world to help our clients and prospects navigate the changing world of work. In fiscal 2024, we will continue to build on that scale for the benefit of our clients. Our GlobalView platform supports hundreds of the world's largest multinational companies with scaled workforces in over 40 countries, and our Celergo platform helps us serve thousands more in up to 140 countries.

In fiscal 2024, we expect to expand on both as we add additional countries to GlobalView's broad reach and as we potentially make tuck-in acquisitions to enhance our native in-country footprint. After establishing an ADP in-country presence in 5 new markets in 2023, we expect to expand further in fiscal 2024. Our world-class global scale distribution, led by over 8,500 sellers is being supported by headcount and marketing investment in 2024, and as we've shared with you in the past few quarters, our sellers will continue to be paired with a best-in-class sales tech stack, which we plan to enhance with Gen AI functionality in the coming months. And our ability to provide data-driven insights will continue to grow in fiscal 2024.

ADP serves more clients and pay more people around the world than ever. And as we continue growing the number of employees we serve globally, the power of our insights will likewise continue to increase and benefit our clients. I am incredibly excited about these 3 strategic priorities for ADP, and the differentiation and growth they will continue to drive.

But before turning it over to Don, I wanted to take a moment to recognize our associates for their effort and performance over the course of this year. Our associates embody our core values like insightful expertise, service excellence and being results driven. In fiscal 2023, ADP was recognized

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as the world's most admired company by Fortune Magazine for the 17th consecutive year, signifying the incredibly strong culture we have and the important role we play in the world.

Additionally, we were recently recognized for the first time as one of the best companies for innovators by Fast Company, a true testament to the direction we are headed in. We owe these accolades as well as our strong, consistent financial performance to the commitment and effort of our 63,000 associates that make up the ADP family.

With that, I'll turn it over to Don.

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 2024 financial outlook. Q4 performance was very strong overall, driving fiscal '23 results at or above our expectations. As Maria mentioned, these results reflected broad-based strength in Employer Services and PEO new business bookings, better-than-anticipated Employer Services retention and continued healthy Employer Services pays per control growth yielding 10% organic constant currency revenue growth for the year, and bringing us to $18 billion in revenue.

For our Employer Services segment, revenue in the quarter increased 11% on both the reported and organic constant currency basis. This stronger-than-expected revenue growth was a function of continued outperformance in retention and pays per control growth as well as a better than anticipated contribution from client funds interest. Our ES margin expanded 480 basis points in the fourth quarter, which was broadly in line with our expectations.

For the full year, our ES revenue grew 10% on a reported basis and 11% on an organic constant currency basis, and our ES margin expanded 190 basis points. Growth in client funds interest helped us in a year in which we added a fair amount to our product, service and sales headcount, which has driven some fairly substantial benefits in sales, Net Promoter Score and retention results.

For our PEO, revenue increased 4% for the quarter, decelerating slightly from Q3 as we anticipated. Average worksite employees increased 3% on a year-over-year basis to 722,000 and has started to gradually reaccelerate supported by very strong bookings growth in Q4. PEO margin contracted 110 basis points in the fourth quarter, in line with our expectations due in part to higher selling expenses. For the full year, our PEO revenue grew 8% and average worksite employees increased 6% and our margin expanded 60 basis points, all in line with our most recent guidance.

I'll now turn to our outlook for fiscal '24. While the economic backdrop remains uncertain, we continue to believe we are well positioned to deliver solid overall financial results while also investing for future growth, consistent with the strategic priorities that Maria laid out. Our fiscal '24 outlook assumes some moderation in economic activity over the course of the year, but nothing dramatic.

Beginning with ES segment revenue, we expect growth of 7% to 8%, driven by the following key assumptions. We expect ES new business bookings growth of 4% to 7%, representing a solid growth after a particularly strong fiscal '23. For now, we're assuming a stronger first half and some moderation in second half bookings growth, which we think is prudent given the limited visibility into the macro environment.

For ES retention, we finished fiscal '23 at a record level of 92.2%, consistently outperforming our expectations throughout the year. We are, of course, very pleased with this performance as we overcame headwinds from higher down market out of business levels with strength elsewhere. With that said, we are contemplating a 50 to 70 basis points ES retention decline for fiscal '24 due in part to an assumption that small business losses will increase slightly from where they are today as well as an assumption for general impact to our other businesses from a slowing economic backdrop.

As we called out 3 months ago, we see the potential for below normal pays per control growth in fiscal '24, and our outlook assumes 1% to 2% growth for the year. We had a strong Q4, which gives us a solid starting point for growth and a gradual deceleration over the course of the year feels reasonable at this time. And after price contributed 150 basis points to our ES revenue growth in fiscal '23, we are anticipating a smaller contribution in fiscal '24, though still above our recent historical average contribution of around 50 basis points.

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And for client funds interest revenue, the interest rate backdrop has been dynamic these past few months, and it is important to keep in mind that our client funds interest revenue forecast reflects the current forward yield curve, which will, of course, evolve as we move through fiscal '24. At this point, we expect our average yield to increase from 2.4% in fiscal '23 to 2.8% in fiscal '24. We meanwhile expect our average client funds balances to grow 2% to 3% in fiscal '24. This is a bit lower than recent trends due primarily to more modest contribution from pays per control growth and an assumption for more moderate wage increases. Putting those together, we expect our client funds interest revenue to increase from $813 million in fiscal '23 to a range of $955 million to $975 million in fiscal '24.

Meanwhile, we expect the net impact from our client fund strategy to increase from $730 million in fiscal '23 to a range of $815 to $835 million in fiscal '24. For our ES margin, we expect an increase of 130 to 150 basis points driven by operating leverage and contribution from client funds interest revenue, offset by continued investments across our strategic priorities.

Moving on to the PEO segment. We expect PEO revenue and PEO revenue excluding zero margin pass-through to grow 3% to 5% in fiscal '24. The primary driver for our PEO revenue growth is our outlook for average worksite employee growth of 3% to 4%. This represents a gradual reacceleration from the 3% growth we're stepping off of in Q4. Strong bookings performance has already contributed to accelerating client growth, but that has so far been offset by slowing pays per control growth.

With continued strong bookings growth, our worksite employee growth should gradually reaccelerate as well. And as Maria shared, demand has been healthy, and we remain confident in the long-term growth opportunity in PEO. We expect PEO margin to be down between 20 and 40 basis points in fiscal '24 due to anticipated higher selling expenses as well as year-over-year headwind from a lower workers' compensation reserve release benefit than we experienced in fiscal '23.

Adding it all up, our consolidated revenue outlook is for 6% to 7% growth in fiscal '24. And our adjusted EBIT margin outlook is for expansion of 60 to 80 basis points. We expect our effective tax rate for fiscal '24 to be around 23%. And we expect adjusted EPS growth of 10% to 12%, supported by buybacks. One quick note on cadence. At this point, we expect total revenue growth to be relatively consistent quarter-to-quarter, but we expect our adjusted EBIT margin to be down slightly in Q1 on a year-over-year basis and then build over the course of the year.

Thank you, and I'll now turn it back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ramsey El-Assal with Barclays.

Owen Robert Callahan - *Barclays Bank PLC, Research Division - Research Analyst*

This is Owen on for Ramsey. I appreciate you taking our question today. I was just curious more on kind of your PEO revenue guidance. I know you called out worksite employee growth weighing on growth there. But you expect double-digit kind of bookings growth and projects only 3% to 5% growth in PEO revenues for fiscal '24. I was just curious if you can provide any more color on that spread, is it's any conservatism or if there are any other factors to consider there?

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

Owen, thanks. Yes, I'll answer the question. We had a very, very strong sales bookings result in Q4. So we're very happy with that, and we've seen the sales reaccelerate. I think as we said in the prepared comments, we are seeing continued growth in clients. I think if there's a challenge that we're facing a little bit is we're seeing a little bit softer pays per control growth in the PEO than we would have expected. But back to what we've

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been saying for some time, we think the underlying value proposition is very, very strong, and we look to that business continue to grow for us and be a big part of our portfolio.

Operator

Our next question comes from Samad Samana with Jefferies.

Samad Saleem Samana - *Jefferies LLC, Research Division - Equity Analyst*

Congrats on the strong end to the fiscal year. Maybe first question, Maria, I thought it was very interesting about the announcement of moving Roll into new international markets. How should we think about maybe what the opportunity there looks like? How much different is the complexity around payroll processing in international markets versus the U.S.? And have you included that in the bookings forecast for fiscal '24?

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

Yes. Fair enough. Thanks, Samad. And I appreciate the congratulations on the quarter and the year. We're obviously pretty proud over here. So with respect to Roll, it is exciting. It's been an exciting product for us to roll out, no pun intended across the down market here in the U.S. We're excited to take it into international. As mentioned, the initial goal is to put it into 2 countries, and it is an incremental add for us because it's really initially into these 2 countries. We're thinking more kind of the down-market SMB space, which is an area of opportunity for us across many of the markets that we serve. But we're also excited about Roll long term beyond that space. And so excited to dip it into our international space as we have continued the overall rollout of Roll.

In terms of factoring it into the overall bookings, not really. I think the -- by the time the launch happens and as we're thinking about the full year for our international business or full year for new business bookings, I'd be surprised if it ultimately makes a dent. But to us, it's really about the long-term value that, that offer will bring as we seek to expand the addressable market for us into these various places.

Last but not least, Samad, you mentioned the complexity of being international. And I have to tell you, I spoke to it a little bit in the prepared remarks. There's a lot that goes into being in each one of these countries. To your point, there's complexity country by country. Many countries put many of the states that are complex, here in the U.S. to shame in terms of the complexity that provides. And that's everything from government entities, legal tax attorneys, who is the tax authority and how do you get to them. We often think of it as an ecosystem. We think about it as kind of that final mile, if you will, and that's the complexity, and that's what we've been building over the last couple of decades in our international business.

So it's a lot more than dropping off software at a country border and hoping that it works. There's a lot to be said for the ecosystem around it, again, whether it's tax authorities, state lodgements, things of that nature. So excited to take advantage of the footprint we've built and put in our products into that footprint as we expand Roll internationally.

Samad Saleem Samana - *Jefferies LLC, Research Division - Equity Analyst*

Very helpful. And then maybe just a quick follow-up for Don. I know you gave -- you called out that broad base strength that drove the bookings upside and you cited several specific factors. I guess it would be helpful if you could maybe help us dimensionalize where the upside was relative to the company's own expectations at maybe the start of fiscal '23? And what you're carrying forward from what you saw in the fourth quarter into the FY '24 bookings outlook?

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

Yes, Samad, thanks for the question. I'll start here, and I think I'll turn it over to Maria for the bookings. But we certainly saw a strength across the board. I think once again, in the prepared remarks, we called out the -- our tax business and our international business. So they were very strong amongst all the ones that were strong and the down market was also quite strong. So it was really a contribution from across the board in the fourth quarter.

We talked for some time about how the pipelines are healthy and whatnot, and you've had questions before about times to get signatures on deals, et cetera. Things came together in the fourth quarter, and we were very, very pleased with the final result.

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

That's right. I -- my only add to that comment would be, we stepped into the quarter with healthy pipelines with a strong staffing position that was growing tenure. I have to tell you, when I reflect on all the quarters that I've watched across our sales execution, generally speaking, you have a bunch of businesses that are outperforming and you have a few businesses that are perhaps being carried by those that are outperforming. What I have to tell you is this was a broad-based strength across the entire organization sales implementation service, with kind of an all hands on deck execution, and that's really what it's all about. What I would attribute it to is incredible execution.

Operator

Our next question comes from Bryan Bergin with TD Cowen.

Bryan C. Bergin - *TD Cowen, Research Division - MD & Analyst*

I wanted to follow up on E.S. bookings here. So you cited several areas of strength, mid-market, compliance and international. On the mid-market specifically, can you talk about what's driving that better-than-expected performance? Do you think that's driving improved competitive performance versus kind of rising tide environment? And then just I heard you comment on Next Gen HCM contributing more in the current fiscal year to bookings. Maybe talk about the initiatives and the product development that you think is going to drive that?

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

Bryan, so I'll comment on both. The mid-market strength that we've seen and it is coming in a bit better than expected. It's been solid for quite some time. That's inclusive of our HRO offerings, and as you know, we've been speaking to those quite a bit in terms of the resonance of that value proposition in the market. So I think that adds to the overall strength that we have in the mid-market, which is the various flavors and offers that we have.

I think the other is that we've made tremendous investments into that business. So we do have our Next Generation Payroll engine that the sales force is pretty excited about and we're seeing that in the wins that are coming in and just kind of the momentum there. I think the other is the amount of product investment and innovation that we've done in the mid-market, specifically referencing the investments we've made into the Workforce Now platform with the new UX and many of the things that I've been speaking to.

And I think the other call out is it definitely helps on a new business bookings perspective, when the business on the other side, so service and NPS, if you will, as well as retention are firing on all cylinders. And that's exactly the case. We have record retention in our mid-market, and we have near-record NPS results across the mid-market. So really, really proud of the execution in that entire space. And that definitely fuels and feeds the ability for our sellers to get excited about everything that I just mentioned to go to market.

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Stepping into the question around Next Gen HCM, I did make a reference to that. We've talked a lot over the last quarters about this year. And what we've been working on is scaling implementation, and that's exactly what we've done in that business. So we were able to onboard a lot of the clients that we had on our backlog. We've shortened the time of implementation, and we also saw additions to that backlog.

So we saw new sales in the fourth quarter of that Next Generation HCM platform. We're really excited about the momentum as we step into '24. And as such, we believe that Next Gen HCM will be a larger contributor to bookings for us in the upcoming year than it was in '23, but we were pleased with what we saw in the fourth quarter and the momentum heading in.

Bryan C. Bergin - *TD Cowen, Research Division - MD & Analyst*

Okay. Understood. And then just on pricing, can you comment on where that ended up in fiscal '23 and what you're assuming in ES growth from a pricing standpoint in fiscal '24?

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

Yes. So we were happy with our price increase and retention. So as we've talked to many times, we want to make sure that we're not getting greedy. So we did get about 150-basis points of price in the year. And we did that without the expense of seeing a decline in retention or NPS scores. And quite frankly, those NPS scores have stayed healthy despite the price increase. So as much as price increases can land well, they have landed well, and we're very happy with how that transpired throughout '23.

For '24, we do expect to have price increases again. We do not think that we're going to be in the 150 basis point range. We're certainly going to be above our historical average of about 50 basis points. But once again, we'll watch closely and make sure that the underlying value proposition for our clients stays in place, and we'll take some price for sure, but not to the extent that we did in FY '23.

Operator

Our next question comes from Tien-Tsin Huang with JPMorgan.

Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

With the great bookings here, I'm just thinking around the conversion. You mentioned implementation cycles. I'm just curious if you've seen any change from clients and their desire to implement. And then similarly, just maybe based on your comments there on Next Gen HCM, I'd love to hear a little bit more around the appetite from your prospects to upgrade now at this point in the cycle. What's the pitch here given some of the macro uncertainty?

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

So I think both of your questions, I just want to confirm, I'm hearing them the right way. I think they both kind of speak to the general sentiment around the demand environment. Is that kind of a good way to think about it?

Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Yes.

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

In terms of decisions getting delayed and/or what's the appetite to, I suppose, by HCM in the current macro environment. And so I'll comment on the general demand environment and feel free to follow-up with an additional question if I didn't cover what you wanted. But the way that I think about demand, and I've spoken to it quite a bit over the last couple of quarters. Demand remains strong, and that is very broad-based across the business. And so if you think about the down market, you still have the strength of small business formations. You have the strength of hiring that's happening in the down market. And as such you have clients there needing to make decisions around our HCM offers in that space, right?

So that's definitely a place that we've been winning, and we'll continue to lean in as warranted by the demand. The mid-market, as we talked about that a little bit earlier in terms of the overall demand there for the complexity that exists in that market. That's inclusive again of the solution we have around our HR outsourcing offerings. And so that's kind of the mid-market.

So getting to your question, which is really about the enterprise space and perhaps even the MNC space, it is an area that we continue to watch as it relates to demand cycles, decision delays. And the main reason is those are really the places that you -- as you're aware, have additional, perhaps signers, additional levels of approval, things of that nature. And what I would say, which is consistent with what we've been seeing, is that we are back to pre-pandemic levels. So deal cycles did shorten during the pandemic, and they elongated back to pre-pandemic. But it isn't something that we're seeing additional elongation beyond historical averages.

And so to your point, though, it is an area that we consistently watch both in the enterprise space as well as in our international business, just to kind of see if the demand cycle is at the client's appetite to make buying decisions or implementation decisions during this time has changed thus far. We're not seeing it in a broad-based way. But it is an area that we continue to monitor.

Tien-Tsin Huang - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Okay. No, that's great. You answered it better than I asked the question. Just on the -- as a quick follow-up, just I heard a lot about the sales and the go-to-market investments that makes sense. Just how about R&D growth here in the upcoming year versus fiscal '23? How might growth be different? And also, how might the composition be different in terms of where you're placing your bets on R&D. That's all I had.

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

Yes. I think we have a number of projects that we've shared with you all over the past number of quarters. Those projects are well underway. We won't spend a lot of time talking about specific Gen AI product -- projects, but I guess that would be a place that would anticipate, I'll get a question -- we'll get a question for that later on in this call, given it's so topical.

But generally, we're continuing our direction with the investments that we've described over the past number of quarters, and we continue to make good progress. We continue to have good delivery. The ability to take Roll to markets in Europe is an example of that, how investments in that development and that technology has increased. And by the way, that's part of our broader strategy that we've touched on many times, is to take some of these developments and make sure that they're global in nature as opposed to only local in nature. So nothing incredibly new, just a continuation of the great work and the great projects we have underway.

Operator

Our next question comes from Mark Marcon with Baird.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Let me add my congratulations, particularly on the strong new bookings. Maria, you went through your 3 key strategic initiatives and all the subsections, of the various initiatives, which ones are going to be the most impactful do you think from a near-term perspective? And then one

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specific question. Within the mid-market, you mentioned not only deploying Next Gen payroll, but you also talked about the time engine. And I was wondering if you could elaborate a little bit on that.

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

Sure. And thank you, Mark. I appreciate the congratulations. So I am very excited about the strategic priorities as I outlined during the prepared remarks. I don't know that I was necessarily expecting to have to pick a favorite pillar or a -- one that I expect to yield impact faster than another because I think broadly speaking, they apply across all of ADP, and they will depend a bit as it relates to kind of each business, right?

And so when I think about some of the product investments that we're making, some of the things, the work that we've done and the impact, whether it's taking a product like Roll internationally, which I mentioned earlier, won't be in a short-term results, but some of the impact of continuing to build on the momentum we have in the mid-market with our Next Generation Payroll engine, as an example, where we have an ability to win differently, we see competitive advantages and differentiation there. I think that's an area that can have tremendous impact in short order.

I think the other is, Don did it first, which is he mentioned the likes of generative AI. And when I think about that, the Gen AI and applying it broadly across these pillars, I think there is opportunity for us in product that's pretty tremendous, whether it's solving real opportunities for our clients to become more efficient. We've talked a lot about that, whether that's things like job descriptions, performance reviews, things of that nature.

But it also leads me kind of to that second pillar to your point around what will come short term versus long term. I think there's opportunity in the short term that will make impact as well as the long term in terms of really applying generative AI across our expertise that we provide to our clients. And so when I think about our ability to make it easier for our clients to engage with us or our associates to engage with our clients, some of the tools that we have already deployed across various businesses and will further deploy into fiscal '24, such as -- think of it almost as a copilot agent assist where we're helping our agents be more efficient. That's going to yield short-term results if nothing else in client satisfaction. And again, we know happy clients lead to a longer staying clients that leads to more sales and the wheel if you will.

So I think there are opportunities across all of the strategic priorities to have some impact us in the sooner than the long term. But yes, I'm equally excited about all of them. And certainly, we spoke quite a bit about the global piece.

In terms of the next generation time engine, that is being developed in tandem with our Next Generation Payroll engine. And those 2 things are really about time and payroll sitting together in our mid-market. It is a based on the same backbone of technology.

And so we're very excited to take that more broadly across the mid-market as we continue to take the Next Generation Payroll engine also more broadly crossed. And I think both of those things will get feathered into the impact of our win rates, if you will, and our new business bookings in the mid-market throughout the course of '24.

Mark Steven Marcon - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And then, Don, you mentioned the margin expectations for the full year. And you mentioned that in the first quarter, it's probably going to be a little bit lower and then feather up over the course of the year. How much lower during the first quarter? And what's the driver there? And then how should we think about the pacing of the improvement quarter-to-quarter?

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

Yes, Mark, thanks for the question. The -- we're not looking at a big change in the first quarter, but just a couple of the drivers. Just to be clear. One, we do have some incremental investment in cost and headcount, et cetera. But the other big driver in the first quarter is it's a big borrowing quarter for us in our laddered client fund interest strategy. So that's going to put a little bit of pressure on the margin for the fourth -- sorry, for the first quarter. And the margin will continue to build over the course of the year, and we will get the overall improvement that we expected, but more out of the 3 quarters as opposed to the first.

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Operator

Our next question comes from Eugene Simuni with MoffettNathanson.

Eugene M. Simuni - *MoffettNathanson LLC - Analyst*

I want to come back to the PEO for a second. So great to hear about strong PEO bookings in the fourth quarter and going into the new year. Can you provide a bit more color on what helped generate this reacceleration in bookings? I know you talked in the past, Maria, about some of the actions you guys have taken to generate PEO sales. I would love to hear what caused the acceleration in bookings? And are those initiatives that those kind of levers you're pulling now completely pulled or is it still work in progress and will continue into FY '24?

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

Sure, Eugene. PEO bookings, again, we're incredibly pleased with the results in the fourth quarter and the reacceleration. We also did see the reacceleration in the third quarter. So the back half of the PEO was exactly as you suggested. It was a lot of focus for the management team, and I'm really excited about how we came together to execute. And in terms of the overall demand trends in long term, short term, I remain bullish on the overall value proposition of the PEO and the demand that it warrants. It's hard in that business to kind of pin down the demand trends because there are so many variables. And in the PEO, it's not as simple as looking at just leads and number of request for proposals that are coming in, because as you know, not every client is a potential fits.

So it's a little difficult to pin down kind of the various demand trends in the specificity outside of the overall belief in the demand environment. And there's normal level of kind of variability as it relates to PEO bookings quarter-to-quarter, which also makes it hard to kind of spot various trends. Some of that has to do with the calendar year-end, some of that has to do with when renewals happen. But nonetheless, there was a tremendous amount of focus and still remains. We remain very focused as a team across all of the leadership to make sure that we continue to drive the strong growth in bookings in the PEO in '24.

Eugene M. Simuni - *MoffettNathanson LLC - Analyst*

Got it. Okay. And then for my follow-up, probably for Don. You talked about margin costs a little bit. So you expect another year of robust margin improvement next year, but obviously, you're not going to have as much tailwind in revenue growth as you had this year. And if you kind of do some of the back of the envelope math, it looks like your adjusted OpEx will need to grow slower next year than it did this year for you to hit your goal. So just hoping maybe you can talk a little bit what are the areas of spend where you will temper next year or maybe pull back, especially if macro conditions are not as good as kind of we expect them to be.

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

Yes. So thanks for the question. Let me start by what won't change. So what won't change is that we'll continue to make sure that we invest in key areas of the business to make sure that we can run it effectively and with the strong bookings, we'll make sure that we have the people on the ground for implementation to get those deals up and running and generating revenue for us, et cetera.

But in the last year, we did have pretty substantial growth in -- over the last couple of years coming out of the pandemic, I can't believe we're still talking about the pandemic but as we came up with that, we did have substantial growth in expenses, in service, implementation, sales, et cetera. And while we do continue to expect to see some growth, we're not going to see as much growth in expenses in those areas.

So that would be one of the areas that is going to make sure and you hit on that with respect to OpEx, we're not going to see the growth in OpEx expense that we saw in the prior year.

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The other contributor, of course, that will continue to contribute, I think the yield curve is more favorable than it was the last time I spoke to you all. We will get contribution from client fund interest next year. But at the same time, it's not going to be to the extent that we did in '23. So that's also going to help with driving margins higher. But once again, not the same tailwind -- tailwinds that we had in '23. I think those are the main items that are going to help us improve our margins going into next year.

Operator

Our next question comes from Scott Wurtzel with Wolfe Research.

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

Maybe, Don, first on the cadence of revenue growth. I know you said it should be relatively stable throughout the year, but wondering if you can maybe sort of parse that out between ES and PEO if there's any differences we should think about there?

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

Yes. So I think revenue growth is going to be -- revenue growth is going to be pretty consistent throughout the year as we start that big backlog that we now have as a result of that very, very strong fourth quarter bookings result. So we will see consistency there. Likewise with PEO, it's going to be a bit of a slower burn as we did have strong sales in Q4. So we did also talk about slightly lower pays per control growth in the PEO business. So -- but I don't think they're really going to be that different. I think they're going to be pretty close if you think about the overall growth and when you consolidate the results for the company, not substantially different between the business units.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

Yes, Scott, there is a slightly different cadence for the 2, it's not a huge difference. For PEO, we do expect an acceleration over the course of the year. So the contribution we get from our bookings and from the improvements in retention, we're expecting gradually overcoming slowing pays per control that should lead to an accelerating PEO revenue growth.

And on ES, we're expecting some deceleration assuming pays per control decelerate and assuming the contribution from client funds interest starts to fade gradually over the course of the year. So you end up with 2 different-looking ramps, but they offset and that's what nets us to a very stable revenue growth overall.

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

Got it. That's very helpful. And then maybe just a follow-up on the Gen AI topic, going back to it. Obviously, there's a lot to sort of be excited about there. But just kind of wondering the magnitude of investment needed there, is that investment essentially all incremental to your investment plans for the year? Or have you had to maybe put some other projects on the back burner to focus a little more on Gen AI?

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

Yes and yes. And so said differently, the good news is we just went through our strategic plan process in the last 6 months. And so we had all of our priority sequence in all of our investments and incremental investments lined up. As we marry that to Gen AI, we have a very clear lens on where some projects may get enhanced, and where some projects may look different and perhaps get replaced by a new way of thinking about it.

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And so candidly speaking, we're going through a lot of these opportunities at this juncture kind of thinking through the bets and there will be incremental investment, and there will be other investments that we repurposed to go do some of these things in a new way. So the answer is both.

Operator

Our next question comes from Peter Christiansen with Citi.

Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

I'll also add to the congratulations ratio. Nice trends. Maria, a question on the international scaling effort here. I was just wondering if you -- in this context, if you could put some parameters on expected investment spend, I guess, over the next 1 to 2 years? And do you see M&A as an important contributor to the growth algorithm there?

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

Sure. You started with a question on international. So is the rest of your question about international? Or is it just in general?

Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

Yes, international.

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

About international. Yes. So we have been, over the years, been making in-country decisions on investments. I talked a lot about the, call it, the feet on the street, the final mile of infrastructure that we have to support our international business. And so we will continue to do that. That's inclusive of each year. We go into new markets and some of those are organic ways that we go into new markets. Some of those are actually partners that we ultimately end up at some point, call it, purchasing, if you will, or acquiring. And so the answer is both organic and inorganic. That's kind of how we've built the business over the last 20 years. And we will continue where warranted to think about it both ways. And the decision criteria for us is really about speed.

A lot of times, it's our clients that pulled us into incremental markets. When I think about the 5 markets that we went into this year or the 2 countries that we're heading into with global view, they're byproduct of clients that are choosing to pay employees in certain markets. And as such, for us, a lot of times the decision we make on how to get there, has a lot to do with speed. And as such, again, we will leverage both organic and inorganic ways to get there. So I don't know -- Don, you ran our international business for a very long time, I don't know if you want to add anything.

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

Yes, maybe just to add, I think what we've been doing, Peter, over the last number of years is we have done a number of acquisitions. They've been mostly tuck-ins, but we did have 3 interesting ones over the last year. We acquired an Italian company that has a good budget -- payroll budgeting software tool that's very prominent in the Italian market. We acquired our Streamline Celergo partner in South Africa, and we also bought a very exciting mid-market time-and-attendance product called SecureX in out of Bangalore and India. So -- and that product is available in India, most of Southeast Asia and the Middle East.

So I think that's a demonstration of what we've been doing, we've been looking at and focused on to continue to make sure we grow that footprint, and we do think it continues to be an exciting space for us.

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Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

That's great color. And Don, just as a follow-up, last slide on the maturation schedule of client fund investments, super helpful. But as we think about intra-year investment turnover, should that correlate with the seasonal balance levels that we typically see?

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

Yes. So I think as those investments mature, you're going to see those investments reinvested at higher rates, and we do expect to see our average return go up over the course of the year. The current reinvestment schedules, overnights are reinvesting at 5%. The extended in the loan portfolios are being reinvested at about 4%. We don't expect to see a huge change in the mix although the average duration of our investments has shortened a little bit over the last couple of years, but you can pretty much look at those yields, look at the maturity schedule that we provided and then look at the composition of our portfolio across the overnight, the extended and the long and pretty much come to a conclusion or come to some numbers on where you think we're going to end up.

Peter Corwin Christiansen - *Citigroup Inc., Research Division - VP and Analyst*

Just one quick one. How should we think about the duration strategy, I guess, for the next couple of quarters here, now that the Fed is perhaps kind of like stabilized, but are -- is there an effort to extend duration shorten it? Just any sense there would be helpful.

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

Yes. We've had this question a few times, and the answer is we've been very successful with the strategy that we've had for the last 20 years. We certainly see that there is an opportunity cost not having everything in short today. At the same time, we do believe that the yield curve will normalize and the strategy we've had in place will come back and be beneficial to us over the longer term. So you shouldn't expect any significant change in our investment strategy.

Operator

Our next question comes from James Faucette with Morgan Stanley.

James Eugene Faucette - *Morgan Stanley, Research Division - MD*

I wanted to go back quickly on retention. I know you've touched on it a little bit. Last year, your initial outlook called for around 50 -- minus 50 to minus 25 basis points of retention degradation. But that obviously didn't really play out. And this year, you're starting with a more conservative kind of minus 70 to minus 50. But I'm hoping you could speak to how much conservatism is embedded there? And what are the drivers that you're seeing as a reason to be a little bit more conservative to start than maybe you were last year even?

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

Yes, fair -- it's a fair observation, James. Appreciate it. I think the we thought about -- by the way, I wish I knew the answer, right? So the question you're asking, which is how much conservatism is in there? And that's all to say and you hit the nail on the head, we stepped into this year guiding minus 25 to 50, we're stepping into fiscal '24 with a guide of minus 50 to 70, and we hope -- I'll end -- or I'll start with, we're very happy with where things are. We're firing on all cylinders. We have many businesses that have record NPS results, record retention results, and everything is good.

And so as we step into the year, the way that we are modeling what you would see in pays per control. The way we're thinking about the potential macroeconomic tempering, if you will, specifically in the back half, is really a byproduct of how we see retention.

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Part of what we saw in the fourth quarter that led to the incredible results that we had was that the normalization that we've been seeing in the down market. We did actually see the down market bounce a little bit. So even while it was down year-on-year, it came in stronger than we expected. And so we do anticipate that we may need to give some of that back, which is why we believe it was prudent to align our retention targets to our medium-term targets that we gave back in the Investor Day of 2021.

So I wish I knew the answer to your question in terms of how much conservatism, why we are guiding to what we're guiding is really about the economic outlook, whether that's GDP, unemployment is still at record lows. We haven't seen unemployment rates that low since the 60s. And so our guess is as good as yours at some level, but we did build in some tempering of the economy in the back half, and that's really what's yielding that guide on the retention.

James Eugene Faucette - *Morgan Stanley, Research Division - MD*

I appreciate that color, Maria. That's really helpful and makes a lot of sense. I want to turn quickly also to M&A. You mentioned it in the prepared remarks, also, I mentioned it as part of at least some of your strategic initiatives. What are you seeing in terms of overall valuation levels? And what kind of things would you be targeting in terms of geography or product capabilities?

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

Yes, James. So in terms of what we're targeting, what we're talking about, there's always things kicking around, of course, but we want to make sure that anything that we do acquire either fits well in the core and gives us additional capability, or it's something that really exceeds some functionality capability that we currently have, so that we're not stacking on more and more product on top of what we already have.

The other area, of course, is to make sure that we do things that our natural adjacencies are very strong adjacencies to what we already do so that they fit well. And then thirdly, of course, is making sure that we can sell these things and run these things in a recurring model. So that we can sell them the way we sell everything else we sell today and operate them and expect to get revenue anticipation and good model from what we buy.

So I think those are the things we think about. I think we're hearing a lot around valuations coming down in the press, certainly a little bit of a dearth of activity, if you will, in the M&A space these days. But we do have lots of conversations about acquisitions and whatnot. I still think, of course, everybody is looking to get a premium what they have. And we're trying to make sure that if we're going to buy something, we're paying the right price. But we don't actually get to the point of many of these conversations given the conditions that I stated at the front at the outset to actually have a view on overall valuations in the market.

We likely get to talking about valuation in a very, very few number of cases. Remembering, of course, very, very few of the opportunities we get even get to that conversation. So I don't think I can say we have a general view. But we are focused on what we would have to pay and how things would fit into ADP.

Operator

Our last question comes from Kartik Mehta with Northcoast Research.

Kartik Mehta - *Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst*

Maria and Don, you've obviously talked a lot about the PEO and seems that the demand has really picked up. But I'm wondering, are you seeing any of your customers may be taking a little bit of a breather now pointing to sign up for the PEO because of the uncertainty in the economy and that being maybe more expensive product?

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

The PEO has a tremendous value proposition. I think we always refer to ADP as an all-weather company. I would say the most durable of our all-weather businesses is the PEO. And a lot of that has to do with the ability to flex that value proposition in a downturn pretty quickly. So if you think about clients that are growing, they enjoy the PEO because it's a quick go-to-market.

On the downside, if you will, as clients are potentially trying to work through economic headwinds. The PEO serves as a place that has a clear return on investment, has a total cost of ownership that's very again, very clear. And so I think it's a business that not to suggest that it's not impacted by a downturn, but it's a business that kind of works in both. What I would say is our sales force, we're able to pivot that narrative and that value proposition as warranted. I don't believe that has happened.

So to answer the question, our clients at this point, hesitant to purchase something such as the PEO that's so comprehensive because of the macroeconomic challenges. And my view would be no. I think that's substantiated by the record results that we had in the PEO bookings in the quarter. We also saw that strength in bookings in the third quarter. So I think that value proposition is holding firm. And I think it's a business that should -- should the economic wins ever come to life that we've been expecting for so long. It's a business that can pivot pretty quickly and the demand for the offer remains.

Kartik Mehta - *Northcoast Research Partners, LLC - Executive MD, Director of Research, Principal & Equity Research Analyst*

And then just a follow-up. Don, you talked about obviously pays per control and retention, and maybe retention moderating as the year goes through. For pays per control, would you anticipate that just to get to flat by the end of the year? Or are you anticipating that, that could potentially go negative, and that's how you've built the guidance?

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

No. We're certainly not anticipating this as go negative. We do, though, think it's going to go to somewhere the neighborhood 1% to 2%, which is a little bit less than our historical average. However, I just want to make sure that everybody understands, we're exiting the year pretty healthily. So we figure we're off to a pretty good start, but we do expect that we're going to see a bit of a decline over the next 3, 4 quarters. And once again, we're aligning ourselves to the best we can with unemployment forecasts and et cetera.

Danyal Hussain - *Automatic Data Processing, Inc. - VP of IR*

Kartik, if you're asking specifically about where we're exiting fiscal '24, then the pays per control is effectively decelerating from this kind of 3% range to something flatter.

Operator

Thank you. This concludes our question-and-answer portion for today. I am pleased to hand the program over to Maria Black for closing remarks.

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

Thank you, and thank you, everyone, for joining today. As you've heard, Don and I, the entire leadership team, we're incredibly pleased with fiscal '23, specifically the fourth quarter and the finish.

So I'll kind of end where I started, which is I want to take the opportunity to once again thank the associates that create this performance. It's an unbelievable magical thing to watch it all come together and deliver what we just delivered. And so my gratitude and I celebrate each and every

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one of them. I also want to thank all of the stakeholders, including all of you who listen today, appreciate the support. We're certainly excited for fiscal '24. So cheers to that.

Operator

Thank you for your participation. This concludes the program, and you may now disconnect. Everyone, have a great day.

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